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# [TH]E HOMEOWNERS PROTECTION ACT OF 1997
# S. 318

# HEARING

BEFORE THE

## COMMITTEE ON
## [BA]NKING, HOUSING, AND URBAN AFFAIRS
## UNITED STATES SENATE

ONE HUNDRED FIFTH CONGRESS

FIRST SESSION

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## S. 318

[TO A]MEND THE TRUTH IN LENDING ACT TO REQUIRE AUTOMATIC [CA]NCELLATION AND NOTICE OF CANCELLATION RIGHTS WITH RE[SPE]CT TO PRIVATE MORTGAGE INSURANCE WHICH IS REQUIRED BY [A C]REDITOR AS A CONDITION FOR ENTERING INTO A RESIDENTIAL [MO]RTGAGE TRANSACTION, AND FOR OTHER PURPOSES

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FEBRUARY 25, 1997

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TUESDAY, FEBRUARY 25, 1997



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ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD



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# THE HOMEOWNERS PROTECTION ACT OF 1997—S. 318

TUESDAY, FEBRUARY 25, 1997

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
*Washington, DC.*

The Committee met at 10:05 a.m., in room 538 of the Dirksen Senate Office Building, Senator Alfonse M. D'Amato (Chairman of the Committee) presiding.

## OPENING STATEMENT OF CHAIRMAN ALFONSE M. D'AMATO

The CHAIRMAN. Today the Committee will turn its attention to problems which touch the personal finances of millions of Americans. I'm referring to private mortgage insurance and the abusive practices of charging homeowners for coverage they no longer need.

Private mortgage insurance, or PMI, as it is referred to, protects lenders from defaults when homebuyers don't have sufficient funds to make the traditional 20 percent downpayment. It plays an important part in the marketplace. We welcome it. It makes available homeownership where it might not otherwise be available. We understand the importance of it.

Let us set the record straight. This Senator and Senator Bryan do not oppose PMI, but what we are concerned about is the unnecessary burdens that are continued, in some cases for years, after there is any reasonable need for this insurance to exist. In some cases, homeowners will pay as much as $1,200 a year.

I think if you look at the chart put up before you, you can see that we are talking about literally hundreds of thousands. There were 960,000 mortgagees who carried private mortgage insurance in 1995. That represents over half of all insured mortgages.

This number dwarfs FHA- and VA-guaranteed loans. The PMI market is huge, and the size of this market and the potential for abuse makes decisive action necessary. I would refer my colleagues to Ken Harney's column in this past Saturday's *Washington Post*. Mr. Harney writes:

> An eye-opening new estimate of the extent of the problem came last week when a Dallas-based loan portfolio analyst said he believes that as much as one-fifth of some lenders' mortgage portfolios consist of PMI-insured loans with equities that are greater than 20 percent of current market resale value.

I would ask that this article be made a part of the record.

Now, make no mistake, mortgage insurance is a legitimate financial product that has helped make possible the American dream for millions of Americans. PMI's have allowed millions of creditworthy, working, and middle-class families to realize the dream of home-



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ownership, even if they did not have the cash on hand to make a substantial downpayment.

The bill we are considering would continue to foster the American dream, however it would not saddle homeowners with unfair, unnecessary premiums that could go into the billions of dollars—billions of dollars—that Americans would be paying.

Indeed, if you look at the second chart, you will see that when a person has put down 10 percent on a $100,000 purchase where there is a $100,000 mortgage, after 10 years, they would have a 20 percent equity. That leaves them, over the balance of the next 20 years, paying $7,000 in unnecessary premiums. That is simply wrong.

I want to thank my colleague, Congressman Hansen, who has had his own personal experience with this situation, in attempting to ascertain how he could end his PMI payments. As a Congressman, he was forced to go up, down, and all around before he could finally do that. Imagine what the average citizen is faced with.

This bill serves as a starting point. We will take, obviously, the recommendations of the industry into consideration, the various consumer groups, the lenders, because we certainly want our lenders to continue to lend. But make no mistake about it, this Chairman is determined to see to it that when people have achieved the necessary equity and insurance is no longer necessary, they will no longer be required to make payments that serve no useful purpose, that deprive them of the monies they worked so hard for.

I am going to ask that Congressman Hansen be permitted to make his statement before I take statements from my colleagues, because I know the Congressman has a very busy schedule. Then I will go to Senator Bryan and Senator Shelby.

Congressman Hansen.

## OPENING STATEMENT OF JAMES V. HANSEN A U.S. REPRESENTATIVE IN CONGRESS FROM THE STATE OF UTAH

Mr. HANSON. Thank you, Mr. Chairman. I commend you and the Members of the Committee, and appreciate you for being here and doing this. I think it is very commendable that you would look at this issue.

As you pointed out, I do not think a lot of people fully realize what PMI is. PMI stands for private mortgage insurance. When they go in, some youngsters, to try to get their first home, they are so grateful to get the loan, they almost lick the shoes of the officer as they do it. They will sign anything.

I was in the mortgage business, the insurance business, and the land development and construction business, and I know how you go through these things. When you have a stack of papers that high, the man and woman sit there just signing one right after another, but I do not think there is 1 percent of Americans that have an inkling of what they are signing.

One of those things is, they could not afford the 20 percent down on a home, so they sign this PMI agreement. Is it important? You bet it is important.

Mr. Chairman, I commend you for saying that. I think people have to realize that PMI is a great thing for Americans, and we

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compliment the industry for being so innovative that they could come up with the idea.

The problem is, as you pointed out, now what do we do with it? I would be willing to guess if you asked the majority of people who have a mortgage what PMI is, most of them couldn't tell you. A lot of them think it has something to do with title insurance. Others think it has something to do with the homeowners insurance. I have had people say, well, is it a homeowners one, two, or three? They have no idea of what they are even talking about.

After awhile, they start looking at the thing, and at the end of the year, they get this little statement. On it, it says, this is your balance, this is what you have paid in principal, this is what you paid in interest, this is what you paid in property tax, and here is what you paid on PMI. Then they start wondering, what is PMI?

As you pointed out, I became aware of this when I first moved back here 17 years ago. I bought a place out in Oakton by Senator Hatch, and later, when my family decided that was a bad idea, we bought a condo here in Crystal City. I did not care one way or the other; I just wanted a place to hang my hat for awhile, like many of us do.

I found myself in the position of being an old tightwad conservative, the way I had been all my life. I got this statement out, and it says on there, what you have paid on PMI. I called these people up and asked, what is PMI? They said, it is private mortgage insurance. I asked, what am I doing that for? They said, that insures the person who holds the loan. I said, that is fine, but how long do I keep it on? They gave me a figure. Then this place in Oklahoma sent me a statement. I immediately said, fine, I will pay it down to that.

It was not a big deal, paying it down to that. Yet every time I turned around, I found that was not enough. They kept saying, we may have to change that figure. Then they said, you have to get an appraisal.

Over in the House there is a young man that does real estate on the side, so I talked to Jack and asked, will you take care of this? He said, this is a piece of cake; I will take care of this for you right now, Congressman.

He called down there. That was not sufficient. My administrative assistant happens to have a neighbor who is in the real estate business. He had been working for over 3 years in it, but that was not sufficient. He finally called up and said, it is done.

It was not done. After a period of time, I finally talked to a second mortgage market and they did the job. Let me point out, I am nobody, but I am a Member of Congress. You would think they would spend a little time trying to work on it, but they did not.

Go tell that story somewhere. Stand up in front of the Rotary Club and tell that story. Immediately, people pop up all over the place and say, oh, we have a similar story. It has gotten so out of hand that an attorney down in Alabama somewhere, Frees is his name, started filing class action lawsuits.

There have been horror stories coming into our office. If you had the time, I would bore you stiff with all of these horror stories of good people who paid their mortgages down, religiously made their

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payments, were on time on every one of their payments, but the mortgage company said no, they would not cancel the PMI.

Now, I will not bore you with this, but in my written testimony that I am submitting to the Committee, you will see all of these mortgage people who have said, look, we have this, and we do not care what you say you are going to do for the life of the loan. We do not have to take it off, and we will not take it off.

This cavalier attitude is the thing that really bothers me. Most of the people who are in these halls can probably afford to put the 20 percent down, so you do not see the issue. The issue is not in front of your face. But the people who can afford it least, the guy right out of college, starting out, the person who can barely make it, this grateful young couple who are thanking God because they are going to get this loan, are the people who are paying the price. These are the people who find themselves in the position of having to deal with the cavalier attitude that some of these mortgage people have.

Mr. Chairman, I would like to point out one thing that really bothers me on this. That is, it is a blame game around here. If you talk to the originator and the servicer, they claim it is not their fault, it is the mortgage company's fault. If you talk to the mortgage company, they point to someone else. Everyone is pointing at the other guy.

When people take out the loan, why would it be so difficult to include a statement explaining what PMI is, and what they have to do to have it taken off the loan? I would be a little hesitant to say that it should be automatically taken off, because that worries me a wee bit.

What if the person is delinquent on their loan? I do not think that person should have it taken off. What if there is a possibility, which has been very rare in America in the last 20 years, that the value of the property depreciates? That's something to think about.

Now we get into the appraisers. They are great people, and a very important part of our economy. But how do you do it? That seems to be one of the sticking points we have on this thing. They tell you to get an appraisal, but how do you go about doing that?

When the guy goes out to try to learn about an appraisal and how to have one done, all of a sudden he discovers that he is going to get hit with a $800 or $900 fee. He is paying $25 a month for the PMI. Maybe he is going to swallow twice before getting that appraisal because the kids need shoes and he has to make his house payment along with other things, and the $25 a month is not a big deal to him. So he does not do that.

It is nice to see, though, that the industry, per se, is working on it. I remember being in the insurance industry for many years, and in the development business. I am a firm believer that the marketplace can take care of its own. The only time we step in is when the marketplace fouls up. In my humble opinion, this is one of those situations where a whole bunch of money, in little tiny areas, goes to other people.

When I was working on CPCU years ago, we used to talk about the law of large numbers. We talked about getting a little bit of money from a whole bunch of people, and that is the whole insurance theory. It is not a big enough issue for the Senate, the House,

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or the law to be involved. What person is going to go to counsel for $25 a month? To walk in the gate, to just talk to the guy, he put down $500.

I commend you and the Members of this Committee for looking at this issue. I think we should be very careful, if I may say so, Mr. Chairman, that we craft this legislation in such a way that we do not hurt the industry; that the people who do not deserve to have it taken off, who are deadbeats, keep paying, but that we give the other people a break.

I will not bore you with this, but I have examples of people in Texas, Oklahoma, Utah, New York, and California who have paid down all the way to the end. When these people called up to have the PMI taken off, the person, in a very cavalier attitude said, we have no reason to take it off and we will not take it off. To me, that is the point when Members of Congress step in and say, you went too far.

I would hope, as we hear the testimony of the many fine people who are here today, they give us the viewpoint of their industry. On the other side of the coin, I hope the Committee keeps in mind that, no, it is not always the other guy. Somebody has to swallow part of this and get it done, and I would hope that you move this very rapidly because we have similar legislation, as we have discussed, over on the House side, which we would like to move very rapidly.

With that overview, I would be happy to submit to any questions that anyone on the Committee might have.

The CHAIRMAN. Congressman, let me thank you for your leadership and for sharing your own experiences with us publicly.

The question of having to get an appraisal that could go as high as $800 or $900, is that really necessary, particularly if the lender says, we have no problem with this, should that then be required? Should that be required where people have achieved an equity of, let us say, better than 20, 25, or 30 percent? Would you really require that, or is that just an attempt to keep this going?

As you say, and as we point out, the most important role that PMI plays is giving youngsters the opportunity to buy a home that they might not have been able to purchase otherwise. But the fact is that many, many Americans, millions of Americans, should be able to know that they can opt out, particularly when there is no bona fide reason for that insurance to continue.

I want to thank you. I will ask the Members if they have any questions.

Senator Bryan, do you have any questions?

Senator BRYAN. None, Mr. Chairman.

The CHAIRMAN. Senator Shelby.

## OPENING COMMENTS OF SENATOR RICHARD C. SHELBY

Senator SHELBY. I would like to ask the Congressman a question.

Typically, today, if this is in part of the contract—say I was the mortgagor, I was borrowing the money from the lender. Is there something in the agreement itself that specifies that I pay the PMI for a certain amount of time, in other words, till the value reaches a certain point?

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Mr. HANSEN. We are finding that most of the folks will tell the borrower that when it gets down to 20 percent of the original value, they will take it off.

Senator SHELBY. Is that in the contract?

Mr. HANSEN. I have not really seen that. I have been trying to find that, Senator, and I cannot put my hand on it, where it is. You will notice that as the testimony goes on—with no disrespect to anybody here, but the originator will say, it is not really us, it is the mortgage company; they have it.

Senator SHELBY. Passing it on.

Mr. HANSEN. We have looked at some of these banks, and here is one that has 200,000 or 300,000 of these loans outstanding. Say they are getting an average of $50 a month. Now, what do they do with the money?

Do they make a payment to the mortgage company? No. Most of these people put it in an escrow account, and that escrow account sits there and draws interest.

Talk about a sweetheart deal. How would you like to be in a situation where you have, say, 200,000 loans that you are drawing $35 to $40 a month on, and then you make an annual, a semiannual, or a quarterly payment? You are making big money on that at that particular time.

People just do not take it off; that is the problem. It goes on and on and on. I think——

Senator SHELBY. But is there an agreement? Let us say I borrow some money from X mortgage company. I do not put enough down, so I have to buy the PMI, and I pay so much a month added to my payment.

Is there a side agreement or part of the closing bill that says when I pay it down to a certain level, that drops the——

The CHAIRMAN. If I might——

Senator SHELBY. Do you see what I am getting at?

Mr. HANSEN. Yes, I do. I stand to be corrected on this by people who know more about it than I do.

Senator SHELBY. OK.

Mr. HANSEN. Let me say this, when you walk in, on the face of it, you are told you will pay PMI if you cannot put at least 20 percent down.

Senator SHELBY. Right.

Mr. HANSEN. So the converse reaction to that is, well, if I can put 20 percent down, I do not have to pay it. I do not know if I ever signed or if I have ever seen one in all the closings that I sat through, where it says there is an agreement that they will take it off. I stand to be corrected on that. I have not see it at this point.

The CHAIRMAN. If I might, Senator, I have been informed by a number of the mortgage companies and the staff that most contracts are absolutely quiet as it relates to when you can take it off.

Most say nothing about it. There are four States, and New York is one of them, that have an act in legislation which indicates that at 20 or 25 percent, it can be terminated. Even that State is a problem because they do not know how to get the notice out, and there is no methodology for bringing that about.

So even though people are given the right, the ability to bring this cessation about is not known. Unfortunately, many contracts—

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and we do not have a percentage—many contracts require PMI for the entire life of the mortgage, and that is absolutely unconscionable. That is wrong.

In other words, the person has 50 percent, 60 percent, 70 percent equity, and they still have to continue to pay.

Senator SHELBY. That is a rip-off.

The CHAIRMAN. That is a rip-off.

Mr. HANSEN. In answer to Senator Shelby's question, let me read to you the Mortgage Servicing Company Guidelines. They state:

> You are required to maintain PMI over the life of your loan, unless prohibited by applicable law. We will consider your written request to terminate PMI during the life of your loan, if the additional risk resulting from termination of PMI is acceptable to us and any investor who then owns your loan. The acceptability of such risk will be evaluated based upon a number of factors.

Then they go into the factors I talked about in my statement.

There's one, verbatim, right out of what they say in their own area. Really, in answer to your question, I do not know if there is a written agreement.

### OPENING COMMENTS OF SENATOR LAUCH FAIRCLOTH

Senator FAIRCLOTH. Congressman, if I heard you correctly, you said that you had some reservations about it being automatic. Well, so do I, but how do we get between automatic and some of these, as you have just read, which say, in fact, we hold both ends of the rope, and we will decide when we will let you off?

How do we arrive at a reasonable length for both parties? I feel very much against having some automatic cutoff here, but what is in between?

Mr. HANSEN. It would worry me, Senator, if we went to an automatic cutoff because if I were doing the actuarial work on this as an insurance person, I could see where to spread the risk, I would up the premium. Therefore, it would hurt a lot of people.

In that case, I think you have to almost zero in on the individual situation. You have a deadbeat that does not make his payments. As far as I am concerned, he may be below the 80 percent somehow, but I still don't think I would be automatic on that because you have someone who has not shown that he's a credible borrower.

On the other side of the coin, there's the instance of appraising the property. Who knows how that's going to come out?

Mr. Chairman, I think that is one of the biggest sticky wickets you have in this whole thing.

The CHAIRMAN. Yes.

Mr. HANSEN. How do you come up with a fair appraisal? I think it goes to your question. You find yourself in a situation that for one thing, if they make one of these pie-in-the-sky appraisals that no one can afford, it's not going to work.

On the other side, how do you do it? Most of us look at the property tax notice that we get. But many of us who have been in local government, which I was in for 30 years or so, and in the legislature, know that the property tax is usually way below the actual market value.

I'm just throwing this out as an example, but say you took an aggregate of 3 years of property tax. To me, that would be a good indication of it.

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There's two instances I'm talking about. But in the event that the area shows the values of the homes are not going down, that the person is a good bet, that they're not losing anything, then I think it almost should be automatic, with those caveats.

Senator FAIRCLOTH. I agree with that. I have no problem with the 20 percent. But when the value of the property has declined, the person has totally neglected the house, it's in a disreputable condition, what do we go to then?

The automatic part bothers me. I never thought an ad valorem tax appraisal was too low. I'm surprised to hear you say that. I always thought they were too high.

Mr. HANSEN. I come from Utah, and we're very conservative out there. Let me just say that I think you don't want to take away the individual relationship between the person holding the loan and the person who is the borrower. That's why I said the automatic feature worries me, because you're going to see a premium increase. Anyone can see that. That would be very easy. In order to take care of this number of deadbeats, we just up the premium, and we all take care of them.

Somehow, there has to be a relationship between the person holding the loan and the borrower, and I think I would be very hesitant to be part of law which would take away that latitude the mortgage company would have.

I don't know if I can respond to the question. However, I'm sure people behind me have 15 answers they're just dying to give you.

Senator FAIRCLOTH. All right.

[Laughter.]

The CHAIRMAN. We'll get to them.

Senator FAIRCLOTH. Thank you, Congressman.

The CHAIRMAN. Does anybody else have any questions for the Congressman before we take statements and go to our next panel?

[No response.]

Congressman, I want to thank you. We will be working with the industry. As I said, this is a starting point.

But one thing I think we can all agree on: When people have a substantial equity, and there's no longer a need for these insurance premiums to be paid, then they should have the right to terminate. And they shouldn't have to go through hoops that are just there to make it impossible to do so.

Certainly the lender has a right to see to it that his investment is protected. We're going to talk to the various bankers, et cetera, to see what they think would be fair. To have a person who has paid off 50, 60, and 70 percent of their mortgage and still continue a program that is no longer necessary, in some cases, charging as much as $100 a month, is just intolerable.

I want to thank you for being the person who has been in the leadership in bringing this to our attention. I look forward to us working our way through this in a speedy manner. That's something that's not generally the case here in the Senate, and working in the collaborative effort with you in the House to see that we end this situation that results in people paying literally hundreds of millions of dollars that they should not have to be paying is something I look forward to.

Mr. HANSEN. Thank you, Mr. Chairman. I appreciate being here.

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The CHAIRMAN. I want to start with Senator Bryan. Do you have a statement that you would like to make or put into the record?

Senator BRYAN. I do, if this is the appropriate time.

The CHAIRMAN. Yes, and then we'll start with our first panel.

## OPENING STATEMENT OF SENATOR RICHARD H. BRYAN

Senator BRYAN. Mr. Chairman, let me commend you for your leadership in drafting this piece of legislation, and for convening this very timely hearing. I believe this is one of the most important consumer protection pieces of legislation to emerge in this session of Congress. I'm proud to be a cosponsor and, like you, I look forward to it being processed quickly, and enacted into law.

I think the legislation we have drafted carefully balances the legitimacy of private mortgage insurance, which does, in fact, make it possible for hundreds of thousands, perhaps millions of people who have a very modest downpayment to qualify for a home, the American dream.

At the same time, it is clear, I think, beyond refutation, that there has been an abuse with respect to the collection of this fee. I think Congressman Hansen outlined the problem very aptly.

I'm not sure that we really provide much in the way of additional consumer information by providing the notice of the right to cancel at some future point in time at the close of escrow. It has been my experience, having moved to Washington perhaps more recently than some of my colleagues, that when escrow is closed today, unlike a decade ago, Mr. Chairman, there is a stack of papers like this to sign.

Some of us have had the opportunity of spending a little time in law school, but you by and large are anxious to close that escrow, so you sign those papers. I doubt if many of us have read each and every one.

I don't object to the notice being provided, and I think it should be included. But I don't think that's very meaningful.

I think the critical point for notice to be given is when you qualify to have the PMI canceled, after you have paid your 20 percent, and at that point, the individual borrower can then make his or her decision as to whether or not to cancel it. I suspect in the great majority, the overwhelming majority of instances, the option would be exercised by the consumer to do so in order to save the consumer literally many thousands of dollars, as you pointed out in your own charts that you had available for us earlier today.

There is no question in my mind, from all of the evidence I have seen and from what you have suggested here this morning, that there is a substantial portfolio out there in America that would qualify for this relief immediately, and the dollars are substantial. I look forward to working with you, Mr. Chairman, in processing this legislation.

I see no reason why we cannot move it quickly, acting in concert with our House colleagues. I would think that we ought to be bipartisan, and I would be very interested in hearing later testimony this morning. If our friends in the consumer protection field have any suggestions as to how we might improve this legislation, I look forward to moving ahead with you and them in crafting the final product.

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The CHAIRMAN. Thank you, Senator.
Senator Shelby.
Senator SHELBY. Mr. Chairman, what is troubling to me here is—and perhaps we could pursue this, or the industry could pursue it if we don't do something, where it would be automatic—if somebody buys a house or a piece of property for $100,000 and they pay 10 percent down, they have to buy the PMI because that's part of the deal. But once this mortgage is reduced to $80,000, after they borrowed $90,000 or whatever, then it should automatically cancel. That should be part of the contract or something.

It's unconscionable for somebody to keep paying for something they don't need or are not aware of. The whole gist of the PMI is to protect the lender because the borrower comes in with a smaller downpayment.

Once that security and the mortgage is paid down, it seems to me that the PMI should automatically terminate, that the borrower shouldn't have to notify anybody. The burden should be in the contract. That would be the way I would think about doing it.

The CHAIRMAN. I think one of the things that we're looking at is if there are extenuating circumstances, as Senator Faircloth has mentioned. For example, you may have property in a particular area which may go down in value. Although we don't see it taking place now, we have all seen it at some point or another.

At that point, certainly the mortgagee should be protected and be able to say, well, we can't go along with it. But there should be some guideline. There should be some principle by which he can act, and not just arbitrarily turn it down.

Now, most mortgagees, it would seem to me, would not turn it down. It seems to me that the vast majority, as Senator Bryan has indicated, where there is 20 percent or more of the equity paid and you have appreciation in the market, are going to say, fine, we don't want people paying money that doesn't even go toward the mortgage. It doesn't even help the mortgagee's position in terms of eliminating or paying down the mortgage.

I think we can work that out. We have provided discretion to the Fed for such circumstances to be looked at, so the Federal Reserve could come up with that. This is one of the areas where we will try to work with the industry in order to craft a methodology that sees to it that, under those special circumstances, the mortgagee is protected.

Senator Faircloth.
Senator FAIRCLOTH. Thank you, Mr. Chairman.

Of course, that's exactly what I was getting back to. I disagree with Senator Shelby to the extent that it cannot be automatic. Real estate does not automatically appreciate, nor does it automatically depreciate. But we all have seen people who simply have destroyed residences that they were living in. They have simply allowed them to decline until the value was gone, and the mortgage company would be left holding the bag.

Now, I understand Fannie Mae is coming out with some new guidelines tomorrow on this. If we have automatic termination, the private mortgage insurance companies, as Congressman Hansen said, are very simply going to have to raise the rates to pay for those houses that are given back to them after 20 percent of the

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initial mortgage has been paid, but yet they are returned a house which they will suffer an enormous loss on.

That loss should not be absorbed by the people who have paid for their house. There should be some structure so that people who didn't take care of their house have to pay for it.

The CHAIRMAN. I think we can take care of that, Senator. We will look to give to the mortgagees the ability to deal with those circumstances. They should be given the ability to say, we're sorry, you have a house that has been neglected, or we have a payment structure that shows indifference and, therefore, it would be risky to cancel the PMI at this point. I think we can deal with that.

What I'm concerned about is the millions of people who right now should have the ability to terminate. They should, number one, be advised that they have the right to terminate. Some don't.

Our legislation, if we were to pass it as-is—and I'm not suggesting we do that—is locked in under contractual obligations. There are some mortgages out there that are for life.

Now, imagine the person who has 95 percent equity, or one in their last year of a 30-year mortgage, the house has appreciated, and they're still paying mortgage insurance. Essentially, they're getting no protection whatsoever.

The bank can't even let them out, because they have a lifetime contract. I think we need more than guidelines, but I understand the Senator's point, and you have my commitment we'll work to see to it that mortgagees are protected.

Are there any other colleagues who have statements?

Senator Allard.

## OPENING STATEMENT OF SENATOR WAYNE ALLARD

Senator ALLARD. Thank you, Mr. Chairman. I just want you to know that I support the basic premise of this legislation. I don't believe that consumers should be forced to pay for insurance once you get past that point of risk and where it's unreasonable.

I also realize that there are some technical things we should address in this legislation, such as those just recently pointed out by my colleagues on this Committee. We have changing real estate values. The home may go down in value, but in some cases may all of a sudden turn around and go up.

The home market out there can be pretty dynamic, particularly in a State like Colorado where we have some very dramatic growth cycles, so I appreciate the Chairman's willingness to perhaps make some technical changes.

The CHAIRMAN. Thank you.

Senator Enzi.

## OPENING STATEMENT OF SENATOR MICHAEL B. ENZI

Senator ENZI. Mr. Chairman, I want to thank you for the opportunity to look at this piece of legislation. I do think that homeownership is a big part of the American dream. When I was mayor of a boomtown, as people were able to get a home, you could see a complete change in their attitude. They became responsible people in the community. They suddenly wanted more things for the community, and were willing to participate in getting those things.

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One of the things I look for in any piece of legislation is to see whether it will create more Federal regulation and oversight. I don't think that happens in this bill.

I am in favor of seeing that working families are not subjected to unfair business practices. I think in some instances there are some unfair practices involved with private mortgage insurance.

On the other hand, I see that private mortgage insurance has been the only way some people have been able to get a home, and to get it with as little down as they possibly can. I am anxious to work on this legislation with you, and I would ask for consent to insert a more extensive statement.

The CHAIRMAN. So ordered.

Senator Hagel.

### OPENING COMMENTS OF SENATOR CHUCK HAGEL

Senator HAGEL. Mr. Chairman, thank you. Obviously, homeownership is the essence of the American dream. We all understand that. That's why we're here.

I'm here to listen and learn. Thank you.

The CHAIRMAN. Thank you.

Senator Reed, you were here earlier. Do you have a statement you would like to put in the record?

### OPENING COMMENTS OF SENATOR JACK REED

Senator REED. Mr. Chairman, thank you. I just want to commend you for this initiative, along with my former colleague, Jim Hansen, in the House. You are, I think, dealing with this issue in a very principled way.

I think some of the technical details have to be worked out, and I look forward to the testimony to help us do that. Thank you.

The CHAIRMAN. Thank you, Senator.

I'm going to ask our first panel to come forward: Michelle Meier of the Consumers Union; Layne Morrill of the National Association of REALTORS®; Ken Nicholson of the Appraisal Institute.

Senator FAIRCLOTH. Mr. Chairman.

The CHAIRMAN. Yes?

Senator FAIRCLOTH. I want to submit a statement I had for the record, if I may.

The CHAIRMAN. Certainly. Senator Faircloth's statement will be submitted for the record.

Senator BRYAN. I want to make a similar request, Mr. Chairman.

The CHAIRMAN. Any statements that any of our colleagues wish to submit over the next 48 hours will be accepted for the record. The record will be held open if they need additional time.

Ms. Michelle Meier.

### OPENING STATEMENT OF MICHELLE MEIER COUNSEL FOR GOVERNMENT AFFAIRS, CONSUMERS UNION

Ms. MEIER. Good morning, Mr. Chairman and Members of the Committee. I want to start off by thanking Chairman D'Amato for taking a lead on this legislation in the Senate, and for improving a situation for American consumers by making the mortgage market fairer and more affordable.

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Unfortunately, American families confront many high-cost traps when they begin the process of working with the mortgage lending industry to finance or refinance their home. The stack of papers at closing is one of those potential traps, that stack of papers that Members have alluded to already.

The mortgage lending industry's requirements regarding private mortgage insurance is another one of those high-cost traps for American families. The trap is the requirement that is apparently in a number of mortgage lending contracts, which requires the borrower to keep paying mortgage insurance premiums well beyond the time when mortgage insurance is legitimately needed.

We don't allow dentists to charge their patients for dental work that has not been performed. We don't allow auto mechanics to charge consumers for mechanical work that's not necessary in the first place. We shouldn't allow the mortgage lending industry or the mortgage insurance industry to charge consumers for mortgage insurance that is simply not necessary.

How big is the problem? Well, I very much appreciate the numbers that you have worked with, Senator D'Amato, in attempting to quantify the range of costs each individual family might face when confronted with this problem.

As Senator D'Amato has indicated, the costs can run hundreds of dollars for American families faced with this problem. It has already been noted, but I think bears repeating, a number that was included in a piece that ran in this Saturday's *Washington Post* by the nationally syndicated real estate columnist, Ken Harney.

His story indicated that one analyst, after reviewing a 20,000-loan portfolio, found that 20 percent of the loans in that portfolio, one-fifth of the borrowers, were paying private mortgage insurance, even though their loan had a loan-to-value ratio of 80 percent or less. So 20 percent of the portfolio was paying mortgage insurance that simply wasn't legitimately needed.

We have estimates that, out of all of the residential mortgage loans outstanding in this country, approximately 70 percent of those loans have loan-to-value ratios of 80 percent or less. If only 5 percent of those borrowers represented in that pool are paying private mortgage insurance, the cost nationwide to American families is between $400 million a year and $2 billion a year.

What's to be done? Well, the discussion has already occurred about whether we should have an automatic cancellation at 80 percent, or some variation of an automatic cancellation.

We think it's very important that something that looks like, perhaps with some exceptions, an automatic cancellation be put into law. Unfortunately, if you have lots of discretion remaining with the mortgage lender as to whether to allow the cancellation or not, we'll be right where we are now. That's the status quo, where borrowers are put in the position of having to beg their lender to let them out of the obligation that's been put into the one-sided contract, and some lenders saying, no; hopefully some saying yes, but a lot of lenders saying no.

We definitely take with some seriousness the one concern, in particular, that's been raised, which is the possibility of declining real estate values in some areas. We think with an automatic cancellation put into law, with some exceptions that would allow the lender

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to invoke the special circumstance of declining real estate values, we would be protecting consumers and lenders at the same time.

But we don't want the onus to be left with consumers to fight this battle again and again with each mortgage lender who would like to make an extra buck.

Again, I want to thank Chairman D'Amato and Senator Bryan, the cosponsors of this legislation, and the other Members of this Committee for moving forward with this. We appreciate it and look forward to working with you.

The CHAIRMAN. Thank you very much.

Mr. Morrill.

## OPENING STATEMENT OF R. LAYNE MORRILL 1997 PRESIDENT-ELECT NATIONAL ASSOCIATION OF REALTORS(sm)

Mr. MORRILL. Thank you, Mr. Chairman. I am Layne Morrill, the 1997 President-elect of the National Association of REALTORS(sm). I'm President of Shepherd of the Hills REALTORS(sm) in Kimberling City and Branson, Missouri, and a certified real estate broker.

On behalf of REALTORS(sm), I'm pleased to present our views concerning S. 318, the Homeowners Protection Act of 1997. We commend you, Mr. Chairman, for introducing this proposed legislation to protect homeowners from paying unnecessary private mortgage insurance, PMI. This is an important consumer issue that deserves to be addressed forthrightly.

At the outset, Mr. Chairman, let me make it clear that REALTORS(sm) believes that private mortgage insurance clearly serves a useful purpose. More than half of all homebuyers who make downpayments of less than 20 percent carry private mortgage insurance, while the remainder of the market is served by Government housing finance programs. PMI protects lenders against loan defaults and helps to make mortgage financing more accessible to homebuyers with smaller downpayments. However, we believe that once the homeowner's equity generally exceeds 20 percent, PMI is no longer needed. There is no benefit to the homeowner from these extra mortgage insurance payments.

The National Association of REALTORS(sm) strongly supports the intent of S. 318. REALTORS(sm) policy supports the disclosure of the mortgage insurance carrier at settlement and subsequent written notification to the borrower regarding the right to and the obligations for PMI cancellation.

We support the objectives of Senator D'Amato's and Representative Hansen's bills and their efforts to save homeowners nationwide hundreds of millions of dollars a year by empowering them with the right to cancel their private mortgage insurance when it is no longer needed.

Although S. 318 does not explicitly call for it, REALTORS(sm) believes that the private mortgage insurer should be disclosed to the homebuyer at settlement. Despite the fact that the mortgage insurer's client is the lender, not the homebuyer, homebuyers pay the mortgage insurance premium.

Competent loan servicers should already have in place the technical and human resources to respond to this challenge. Mortgage insurance balances, escrow accounting, real estate tax disclosures,

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are all part of the year-end statement that lenders make to their customers for Federal income tax reporting purposes through the Form 1099 and escrow analysis required by Federal statutes.

There is a win/win opportunity provided in Senator D'Amato's proposal. For REALTORS®, disclosure of pertinent information affecting the terms of a mortgage loan, conditions of homeownership and repayment of the mortgage obligation to the consumer, is a key principle that we use daily. We believe that well-informed home-sellers and homebuyers, fully cognizant of their obligations and rights, should be critical to any mortgage finance transaction.

Some critics may argue that S. 318 goes too far in requiring notification to all homeowners of their mortgage insurance cancellation rights. We believe that universal notification is appropriate because, whether unintentional or not, lenders who retain unnecessary mortgage insurance premiums are doing the mortgage finance industry a disservice in the long run. Retaining or maintaining PMI beyond its usefulness to the homebuyer is a practice that for the good of those associated with the home mortgage industry should be ended.

PMI cancellation should be easier for the consumer. Demands for redundant appraisals, which result in additional costs to the consumer, should not be permitted. Any appraisal by a licensed or certified appraiser should be honored by the lender, and the PMI process should not be thwarted or delayed resulting from failure to reach agreement on appraised value or mortgage principal balance.

Despite the small number of State laws and the existing Fannie Mae and Freddie Mac lender guidelines supporting the cancellation of private mortgage insurance once the general equity threshold of 20 percent is reached, homeowners' excessive payment of PMI premiums continues in an alarming number of instances, once that equity threshold is attained on their mortgage. This is a situation that should end.

This concludes my testimony, Mr. Chairman. I will be pleased to respond to questions.

The CHAIRMAN. Thank you, Mr. Morrill.

Mr. Nicholson.

## OPENING STATEMENT OF KENNETH L. NICHOLSON, SRA PRESIDENT, NICHOLSON & COMPANY 1997 PRESIDENT OF THE APPRAISAL INSTITUTE ON BEHALF OF THE APPRAISAL INSTITUTE

Mr. NICHOLSON. Thank you, Mr. Chairman and Members of the Committee. I commend you for calling these hearings, and thank you for the opportunity to testify today.

I am a practicing real estate appraiser, specializing in residential properties. I reside in Overland Park, Kansas, where I got my start in business working for Capital Federal Savings and Loan more than 30 years ago. I have experience in performing appraisals used in private mortgage insurance cancellation requests. As President, I am proud to represent the Appraisal Institute, which is the Nation's largest association of professional appraisers. I am especially pleased to be here because of our pro-consumer mission, which is to deliver objective information about the value of a person's home and other investments in real estate.

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Mr. Chairman, as I understand it, your legislation calls for the cancellation of PMI when a borrower's loan-to-value ratio equals a predetermined percentage. That ratio, in my area of the country, is generally an 80 percent loan-to-value ratio. I believe that at the time of closing, the consumer should be informed of all the conditions for cancellation of PMI. Presumably, an amortization schedule based on the terms of the initial transaction would indicate a future termination date. Such an approach would rely heavily on the appraisal of the property performed for the original mortgage transaction. With an automatic cancellation based upon the original value of the property, the reliability of the initial estimate of value is critical for the borrower, the lender, and the insurer.

While real estate appraisal is not an exact science, appraisers do employ scientific methods. Valuation estimates are based upon a professional analysis of both physical and economic facts. In 1987, the Appraisal Institute was part of an industry-wide initiative to codify appraisal standards. This initiative resulted in the issuance of national standards known as the Uniform Standards of Professional Appraisal Practice.

To ensure the highest degree of reliability for a value estimate, an appraisal should be performed by an objective and qualified appraiser who is disinterested in the transaction, acting in accordance with these uniform standards. Education, training, and experience help professional appraisers apply the standards in valuation situations which require much skill and judgment. Our association, the Appraisal Institute, confers meaningful designations or, for another word, credentials, which reflect demonstrated competency and integrity. A competent appraiser, when estimating a property's value in accordance with industry standards, will set a reliable benchmark benefiting all parties in the mortgage transaction.

Your legislation also addresses notification and the right to cancel. Unlike automatic cancellation that relies on an original value conclusion and possibly an amortization schedule, cancellation at other points in the loan may or may not need additional underwriting. If, for example, within the first few years, a homeowner is in an appreciating market and has made several home improvements, what are the options?

I recently had a homeowner in that exact situation. The homeowner may believe the property has surpassed the lender's equity requirements for PMI and request that it be dropped. Fairness dictates that a homeowner should be allowed to cancel coverage that is superfluous. It also seems reasonable that such a scenario would be foreseeable and disclosed initially. This way, relevant underwriting considerations for a determination to allow an early out would be a matter for the parties to decide up front—no surprises.

Factors such as credit history, market conditions, and credible collateral evaluations are all part of sound decisionmaking in a mortgage transaction. Appraisers are called upon to act as disinterested parties, to deliver a wide variety of services to meet the needs of clients in today's marketplace. Appraisers are responding now to new market demands for services with expanded and new technologies. Enhanced appraisal tools, databases, and other valid methodologies are being utilized by appraisers to deliver quality valuation products. To the extent that our professional community

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is called upon to help solve the issues involved in PMI notice and cancellation, we are ready.

In summary, members of the Appraisal Institute have as their first priority the obligation to protect the public by providing objective information about the value of homes and investments in real estate. Appraisals performed in accordance with uniform standards by a competent appraiser provide a reliable benchmark on which to base PMI requirements. Today, professional appraisers are prepared to deliver timely and reliable valuation services to assist the homeowners, the lenders, and others in making sound decisions involving real estate.

Mr. Chairman, I applaud your efforts and look forward to working with you and the Committee as the legislation moves forward. Thank you. I would be happy to answer any questions.

The CHAIRMAN. Thank you, Mr. Nicholson.

Senator Bryan.

Senator BRYAN. Thank you very much, Mr. Chairman.

Mr. Morrill, the first question is to you. Do you have any data as to the percentage of home mortgages that would have an equity of 20 percent or more which might be in default in any one year, or any period of time?

Mr. MORRILL. I don't have that information readily available. I do know, from the information which we have in the written testimony, that usually on a 30-year mortgage, after 13 years, the 20 percent has been attained.

But as far as default numbers, I do not have that.

Senator BRYAN. I should think that the greater the equity buildup, the less likelihood there would be a default. Has that been your experience generally in the real estate market?

Mr. MORRILL. Normally, unless catastrophic incidents, divorce, various things of this type, occur.

Senator BRYAN. Ms. Meier, in terms of the notice, I do not disagree with providing notice at the close of escrow. It's been my experience that, even with respect to relatively sophisticated buyers, that is just such a mass of documents. Anybody who has closed an escrow in the last 4 or 5 years, versus what was provided by way of close of escrow 20 years before—there's a big difference between the documents of 20 years ago and documents that look like this today.

You go through this mass of documents, and you're not quite sure what there is, even though you have had some experience in these transactions. I don't object to that. I think it's proper, and our legislation provides for this.

Talk to me a little bit about what, in your judgment, might be a more effective vehicle to notify borrowers of their rights to cancel or to opt out of this provision.

Ms. MEIER. I agree with you that a notice contained in the pile of closing documents may get overlooked.

Senator BRYAN. I don't object to it being there. I'm not sure that really imparts the kind of notice that all of us contemplate.

Ms. MEIER. And it might be a few years before it even becomes relevant.

Senator BRYAN. Right.

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Ms. MEIER. The whole question of notice is very much tied to what kind of right we're giving people here. If you have a right to stop being billed for PMI when you no longer should be paying it, then you don't really even need to know about that right.

In fact, what the lenders should be doing is not including that in your total monthly payment obligation during the year that the cancellation occurs.

I would really urge the Committee to think along those lines, that you eliminate the cost to everybody of universal, across-the-country notices going out if you opt for generally an automatic cancellation at exactly the right time, with some discretion in limited circumstances, reasonable circumstances, for lenders to avoid the automatic cancellation and dispute it with the borrower.

It would only be in that more narrow circumstance, where the lender is worried that the home value has gone down, that the cancellation would not occur automatically, and the lender would need to communicate with the borrower and incur those communication costs.

Senator BRYAN. What kind of circumstances would strike you as being reasonable to be excepted from the automatic cancellation provision?

Ms. MEIER. I really look at the 20 percent equity threshold as one that the industry already uses. Usually, if you put 20 percent down at closing, you are exempt from PMI. It's one based on reasonable risk of default.

There is also, in responding to your previous question, a lot of data out there—and I'm still looking for it, but I think I'll get my hands on it today and I'll send it to you—showing very, very strong correlations between equity in the home and default risk and default experience. It's empirical data.

Because of that empirical data, the industry has set 20 percent as a very important threshold. There are two reasons for that:

Defaults at that point are minimal. Also, if a default occurs in the rare circumstance, there is a cushion of equity in the home that ensures the lender that any sale of the property will bring enough proceeds to repay the balance on the loan.

Senator BRYAN. Would it be reasonable to provide some kind of exception in the situation where you have a homeowner, a borrower, who has a history of episodic defaults, we'll say, over the previous 2 or 3 years? He or she is not in foreclosure, but there have been circumstances which would indicate that this is a questionable loan because there have been defaults, notices, in the past, although perhaps cured at the time that the 20 percent threshold is reached.

Ms. MEIER. Where I was leading was the eminent reasonableness of an exception where there's declining real estate values. Then you don't have that 20 percent cushion that gives comfort to a lender in case there is a default. It's a rare circumstance.

The other exception you raised, where it's the repayment risk that arises, I'm not so sure about. Again, you have the 20 percent cushion there in case that very negative occurrence actually does occur, which is a total default on the loan.

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But we would certainly be willing to consider that in the context of a right that automatically takes effect, rather than requiring the borrower to pursue the cancellation.

Senator BRYAN. I thank you, and I thank you, Mr. Chairman.

The CHAIRMAN. I am going to take some of the time I passed, and then go to Senator Faircloth.

I believe, if we are really going to achieve something here, there has to be some vehicle by which automatic cancellation would take place, unless there are the unusual circumstances which my colleague and friend, Senator Faircloth, has alluded to, where there should be a reasonableness test.

I do believe that most mortgagees are going to be very reasonable. I don't find the institutions withholding unnecessarily. May there be some? Sure.

But the fact of the matter is that we can provide relief for 90 or 95 percent of the people, the vast bulk who today, in some cases, are literally being tied into lifetime contracts, regardless. Even if 50, 60, or 70 percent equity is obtained, some of them have signed a lifetime contract, and that is just absolutely wrong. They're not getting any more value.

I think it is attempting to ascertain that there is a reasonable standard that the mortgagee live up to. Most of them are. They receive no additional benefits from these monies. As a matter of fact, they're being penalized because that would give more expendable income to the mortgagor to satisfy his mortgage.

I think we can handle that. I look forward to working with all the groups, including Fannie Mae, Freddie Mac, those who are in the business, as well as the mortgage lenders and the PMI people.

Senator Faircloth.

Senator FAIRCLOTH. Thank you, Mr. Chairman.

I guess I am somewhat intrigued by the 20 percent ratio. Everybody is saying they can't go below that. I don't know, Ms. Meier, where were you in 1986? Were you in the mortgage business?

Ms. MEIER. 1986? No.

Senator FAIRCLOTH. We talk about the benefits accruing to the borrower. The benefit that accrues to the borrower is, he gets the loan. He can buy the house which he could not buy otherwise.

The question I have is, does he have, in case of default, whether at 10 or 30 percent—does the mortgage lender still have recourse against the homeowner, or does his recourse go totally to the mortgage insurer?

Ms. MEIER. It's my understanding that the lender would have recourse against the borrower at that point also.

Senator FAIRCLOTH. His recourse is not limited to the insurance?

Ms. MEIER. Right, right.

Senator FAIRCLOTH. He could go against the borrower.

Ms. MEIER. That's just special protection in addition to the ability to go after——

Senator FAIRCLOTH. So the sole benefit to the borrower is that he gets the loan.

Ms. MEIER. Right.

Senator FAIRCLOTH. He gets no protection whatsoever against future recourse?

Ms. MEIER. Exactly.

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Also, Senator Faircloth, I would only like to chime in and agree that PMI does serve a very obvious benefit in the mortgage market. In fact, I was able to buy a home because of PMI.

I don't want to dispute that. I totally agree with that point.

Senator FAIRCLOTH. What about the FHA, they never cancel insurance? What's the difference? Why are we legislating the private sector to automatically cancel and not the FHA?

Ms. MEIER. You know, that's a good point. I just am not sure. The rules have changed in the last few years, and I'm not sure at what point, but the structure of premium payments with the FHA program is different because of problems with that program that produced a different Congressionally-mandated formula only a few years ago.

Senator FAIRCLOTH. Now the Administration is wanting to raise the lending rates of the FHA to around $220,000. They want to increase them substantially.

Yet they do not ever cancel the mortgage insurance.

Ms. MEIER. Is that the case? I didn't know that.

Senator FAIRCLOTH. The FHA insurance is never canceled.

Ms. MEIER. What happened a few years ago with increased default occurrence within the FHA program and some dire forecasts that the program could go under unless the premium structure was changed, was that increased premiums were imposed.

To avoid burdening the first-time homebuyers with high up-front premium costs, what the FHA did—and actually Congress crafted this solution—was to require a fairly hefty up-front cost and then annual premiums as a way to stretch out the premium costs to the homebuyers.

The CHAIRMAN. That's correct.

In other words, Senator, in order to cut down on the costs that otherwise would be associated with the up-front monies, they have stretched out the payment of the insurance over the lifetime of the program, and in this way reducing that downpayment requirement which would otherwise defeat the very purpose of letting people put 3 or 5 percent down. It also includes the closing costs.

Senator FAIRCLOTH. By the same token, Mr. Chairman, if 20 percent equity is fair for the private sector, why is it not fair for the governmental sector? I mean, 20 percent is 20 percent.

Ms. MEIER. I understand your point, and I appreciate it. It's just a very different program and is really meant to facilitate low downpayment borrowers.

The countervailing burden to those same borrowers is that they are going to pay premiums for a long time to get into the home.

Senator FAIRCLOTH. I want to commend the Chairman. I think it's a good idea, moving in the right direction.

But I see continuously in Congress, we want to go after more rules, more regulations on the private sector, and yet governmental agencies we tend to let run free.

I thank you.

The CHAIRMAN. I don't want to set off a firestorm here, but I think the Senator raises a good question. Maybe we have to look at the FHA insurance program to see whether we should make some of those requirements and loosen up on them.

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Obviously they're using those monies as it relates to keeping the program and the fund solvent. I recall some years ago that we were on the brink of a very precarious financial position as a result of those tremendous declining markets.

But maybe we should get the FHA folks in here and at least have a hearing on these costs.

Senator FAIRCLOTH. Particularly in view of the fact that they are trying to increase the lending limits.

The CHAIRMAN. I think it might be appropriate for us to do that, and we will look into that.

Senator Reed.

Senator REED. Thank you, Mr. Chairman.

Let me first ask a technical question. Typically, the PMI is not insuring the whole cost of the mortgage. Is that correct? Is it insuring just a small portion, Ms. Meier?

Ms. MEIER. It is only insuring a portion of the loan.

Senator REED. And that portion of the loan is the full 20 percent of the value of the loan? Or is it the difference between what the homeowner pays and 20 percent?

Ms. MEIER. It is my understanding that it is a portion of the loan itself which will represent——

Senator REED. Twenty percent——

Ms. MEIER. —a portion of the value of the home.

Senator REED. OK. So I guess in one sense we have been collectively struggling on the panel about the depreciation of homes and market values falling, but I don't think there is an initial attempt by either the lender or anyone else to insure against declining market values by insuring the whole value of the loan.

Is that true?

Ms. MEIER. Right. Yes. That is a good point.

Senator REED. It seems to me also that really there are two things you are trying to protect here.

The first thing is a record of payment which is prompt, timely, and uninterrupted. That is basically why, when you put 20 percent down, you do not have to have the PMI, and if it is less than that you do.

So it would seem to me—and I would like to get your thoughts—that perhaps, and I agree with the Chairman, unless there is some type of automatic mechanism, there will be every advantage by the insurance company and others not to be as prompt as they might be because they have a financial interest in keeping the insurance in place.

I would think if that record of continuous payment over several years is there, that would probably be the best indication that an automatic termination could be reached if you get to the level of 20 percent.

I wonder what the comments or thoughts are of the whole panel.

Ms. MEIER. I think the history of prompt payments is definitely an indicator that this is a seasoned loan and a good loan and one likely to continue without delinquency.

Again, I also think the 20 percent itself is very significant because once someone has put that much money into a home, they have a huge stake in it. That in itself argues against and dictates against walking away and defaulting.

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Senator REED. I guess another approach, or perhaps mechanism for terminating the insurance would be in terms of an appraisal. I know Mr. Nicholson and Mr. Morrill commented upon that, but in what circumstances do you think an appraisal would be in order for a termination, not an automatic termination, but where there would have to be an appraisal in order to terminate the insurance?

Ms. MEIER. I think if there is some instability in real estate values in the market area, then there might be a legitimate need to have an appraisal.

These are the kinds of aggregate numbers and analyses that are typical of insurance. But rather than on a case-by-case, saying that every single loan needs an appraisal, I think is a waste of money. I would really look to market values in a reasonably defined geographic area.

Senator REED. And that is something presumably the Federal Reserve would do in their Exceptions' Policy by regulation.

Ms. MEIER. Exactly.

Senator REED. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Bennett.

## OPENING COMMENTS OF SENATOR ROBERT F. BENNETT

Senator BENNETT. Thank you, Mr. Chairman. I apologize that I was not able to be here when Congressman Hansen was here. I am one of Congressman Hansen's fans, although I am not his constituent. I live in the district right next to his, and I know him as a man of great passion. I am sure you saw some of that this morning as he expressed himself.

I apologize because I have joined the panel late. Let me just start by asking a very quick and fundamental question starting with you, Mr. Nicholson, and going down the panel.

Are you favorable or unfavorable toward Congressman Hansen's approach?

Mr. NICHOLSON. Senator, I would be in favor of the cancellation options that the Congressman has laid out.

The CHAIRMAN. OK, Ms. Meier?

Ms. MEIER. I have not studied it closely enough. My understanding is that it is primarily a notice bill——

Senator BENNETT. Yes, it is.

Ms. MEIER. —rather than the approach Senator D'Amato takes.

Senator BENNETT. It does not go as far as the Chairman's approach. It is not an automatic cancellation, but is a requirement for an annual notification.

Ms. MEIER. I think it is really essential that the consumer have the right by law to cancel, with some exceptions along the lines we talked about.

Senator BENNETT. So if it is as I have described it, you would be generally in favor of it? Have I put enough qualifiers in there?

Ms. MEIER. As long as there is a true, substantive right that does not require the consumer to jump through a bunch of hoops to get the PMI canceled.

Senator BENNETT. Mr. Morrill?

Mr. MORRILL. Yes, Senator, as far as the REALTORS® are concerned, we are supportive of Representative Hansen's proposal.

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Senator BENNETT. Now I will put you on the spot and move back starting with you, Mr. Morrill, and ask your attitude toward the Chairman's bill which goes a bit farther.

Mr. MORRILL. Certainly, we support the Chairman's bill, also. I think someone had mentioned earlier a good opportunity there was that it would be automatic "unless." And while that I do not believe is set forth, as I recall from having read the legislation, it would be a great opportunity to automatically solve the problem.

Senator BENNETT. Ms. Meier, what is your attitude toward the Chairman's bill?

Ms. MEIER. I am very supportive of the Chairman's provision of a clear right to get PMI canceled at a certain point with some exceptions allowed for.

I agree with Mr. Morrill that some tinkering to make it be automatic "unless" would be helpful.

Senator BENNETT. Mr. Nicholson, what is your attitude toward the Chairman's bill?

Mr. NICHOLSON. As with the Congressman's bill and the Chairman's bill, the Appraisal Institute believes anything which would protect and benefit the public we would be in favor of as long as it is properly administered, with certain caveats.

Senator BENNETT. Thank you. That is very helpful.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Allard.

Senator ALLARD. Thank you, Mr. Chairman.

I would like to have all three panel members respond to the question as to whether you support the provision that the 20 percent equity percentage be based off the original value of the home when purchased. If you do not support that, then how is it that we go ahead and determine an alternate value of that home?

Does that mean we do it without a fee attached to it? Or does somebody go in and pay a fee for a reappraisal on the home?

I would like to have your comments on that.

Mr. NICHOLSON. Senator, the Appraisal Institute does not believe that it would be their right to decide what that percentage should be. That should be up to the industry itself, the lender, and the insurer.

If it is their decision that an additional valuation be made, we would be happy to do it, but that is their call and we do not believe it is our decision to make.

Senator ALLARD. And if they should decide, then who would pay for the appraisal? The consumer, or the lender?

Mr. NICHOLSON. Typically if an appraisal is ordered in the industry, the client pays for the appraisal, and that "client" is the person who orders the appraisal.

But, once again, that is not our decision.

Senator ALLARD. I know. You are working for whoever orders that appraisal.

Mr. NICHOLSON. That is exactly correct.

Ms. MEIER. We think that it makes sense that the cancellation formula be tied to the original value of the home, at least in one formula.

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One thing I have not yet mentioned but wanted to is that we probably do want to accommodate 80 percent loan-to-current-value ratios' borrowers who have reached the 80 percent because of home value appreciation.

I will just put that aside. But your question raised that in my mind, that additionally we might want to formulate the 80 percent based on current market value.

In terms of who should do the appraisal, when it should occur, et cetera, I think if we pursue this approach we're talking about, where the cancellation is automatic under the formula "unless," that it will be in the minority of circumstances that an appraisal will be necessary.

Then I would presume in at least a lot of cases it would be the lender's appraisal.

Mr. MORRILL. I would assume that you are talking about off the original value?

Senator ALLARD. Yes.

Mr. MORRILL. That certainly is the easiest way to reach a level that you could go forward with. Unless you have had substantial market conditions which have placed the property under water or something like that, you automatically have it covered.

Senator ALLARD. So what would you do in an area where you had a large employer who closed the plant causing everybody to leave the community, and your home values to drop by 50 percent, which is what has happened?

Mr. MORRILL. That may be part of the "unless" portion.

Senator ALLARD. You think that is where the exception would be brought in.

Mr. MORRILL. Correct.

Senator ALLARD. Then it raises questions of where is the appropriate level and how do we arrive at the conclusions?

It is easy to create exceptions, but when you create exceptions, how are you going to determine whether they are fair and appropriate? I think that is what this Committee is going to struggle with.

If you may happen to have any suggestions, I personally would like to hear those. Thank you.

The CHAIRMAN. Senator Enzi.

Senator ENZI. Thank you, Mr. Chairman.

Mr. Nicholson, you mentioned that for most cases the original appraisal would work for estimating this reduction with the automatic cancellation later.

What exceptions did you place on that?

Mr. NICHOLSON. If there were changes in the market, and if the homeowner made substantial improvements or dis-improvements, as was mentioned earlier. Anything which would affect the actual physical condition of the property favorably would be an excellent opportunity for a possible early-out option.

Senator ENZI. You mentioned the difference between an estimate and an appraisal, I think, or is that just something I wanted to hear?

[Laughter.]

I was assuming that affected the cost. Could you tell me anything more about that?

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Mr. NICHOLSON. Actually, it does not. An "appraisal" is actually an estimate of value, Senator.

Senator ENZI. OK. Is there any less cost when the property has been appraised at the original time, and then these changes are made, such as improvements to the property, would that be less expensive than going in and doing a full appraisal with all the comparisons of the other properties again?

Mr. NICHOLSON. That would be determined by just what it is the client wants, Senator. If they want something less than a full appraisal, then the cost would be something less.

If there are improvements made to the property, if the client is willing to take the word of the homeowner or the borrower and say that these improvements were done and wants the appraiser to rely on that information solely, then you would have no physical inspection necessary.

But if you were doing an early-out option, in our opinion, a physical inspection would probably be of benefit, but it is not totally necessary.

Senator ENZI. Thank you. I will yield the rest of my time.

The CHAIRMAN. Senator Hagel.

Senator HAGEL. Thank you, Mr. Chairman.

It is my understanding that there has been a surge in the percentage of new loans made over the last couple of years with PMI. Is that correct, do you know?

Mr. MORRILL. I am not aware.

Senator HAGEL. I guess my question is: How would this change affect or connect to high-risk loans? Maybe you could just generally address this and give the Committee your thoughts on the general question of if we move forward with this kind of bill, would it in fact inhibit high-risk loans?

Mr. MORRILL. By "high-risk loans," Senator, to me it means the PMI is covering the difference between the 80 percent and the downpayment.

You might say you are insuring the collateral difference in there. You are not insuring what you would insure as a lender under due diligence, saying that they have had a good payment record, that the property is in good condition, that they are maintaining it, and things of this type.

You are really only picking up the difference between the 80 percent which you would normally have, and the difference that the borrower is making of the 5 percent or whatever it used to be in that situation. So you are not talking about whether the person has really had a bad payment record.

Senator HAGEL. Would either of you care to address that?

Ms. MEIER. Sure. I do not know that it would affect new into-the-future originations of what you called "high risk," by which I presume you mean a low downpayment?

Senator HAGEL. Yes.

Ms. MEIER. Because, to the extent that there has been an increase in the percentage of new originations with PMI, I presume that would reflect a higher percentage of new originations with low downpayments.

I also presume that the premium income which has accompanied those originations will cover that higher risk, and the same would

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hold true for premiums collected in the future for originations in the future.

I do not see the 80 percent cutoff affecting any new originations either way once they reach the 80 percent.

Senator HAGEL. OK. Thank you.

Mr. Chairman, thank you.

The CHAIRMAN. Senator Dodd.

## OPENING STATEMENT OF SENATOR CHRISTOPHER J. DODD

Senator DODD. Mr. Chairman, I apologize for being a few minutes late, but let me thank you for holding this hearing.

I will ask unanimous consent to be able to include my prepared remarks in the record.

The CHAIRMAN. So ordered.

Senator DODD. I have just a few brief points to make.

First, I happen to believe that private mortgage insurance has been a tremendous, tremendous asset for people and I think that has been stated here based on the testimony I have read. We have to be careful in our discussions that we do not undermine what has been a tremendously valuable tool to people who could not meet that initial threshold to get them into homeownerships.

I would preface any remarks I have and begin by stating my strong support for the existence of PMI. I think it is tremendously, tremendously helpful.

Second, with anything like this, you can see people taking advantage of a situation to a degree where consumers are adversely affected, and that is obviously happening. I commend the Chairman for the introduction of this bill.

Finally, and I gather this is a point that some of my colleagues were raising here, I am somewhat adverse to the notion that we have to, in every instance, protect consumers from themselves.

I have a lot of confidence in people's ability to make intelligent decisions if they are provided with the information. Making sure people know exactly what their obligations and rights are, and then allowing them to exercise those, is the best course to follow in some instances.

The Chairman will recall a few years ago we did that on the credit card disclosure at the time of solicitation rather than, in that instance, absolutely banning certain activities. We insisted that consumers be given the information.

As it turned out, given that information, consumers made very good choices, and lending institutions accommodated their own practices based on just what was smart for good business.

To draw another quick analogy, the Chairman has some legislation, which I think is on the right track, dealing with the fees that are being charged on these automatic tellers. There I think the question is not so much choice; it is just people being gouged.

I am not sure in this particular case whether we want to mandate a certain thing from happening, or whether we want to allow consumers to make the choice so that they will have the tools to protect their own financial interest.

I am not yet clear myself, Mr. Chairman, in that section of the bill as to whether we absolutely mandate that the practice stop, or whether we provide the information to the consumers so they can

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make the decision as to whether or not they want to terminate the insurance once their obligations have been met.

With that, I would just as soon hear some of the testimony and the questions my colleagues may have for the witnesses. I want to thank the witnesses for being here.

Thank you again, Mr. Chairman. This is a very, very important issue. When people are being gouged, as they apparently are in this instance, we must try to come up with a mechanism to offer them some protection.

The CHAIRMAN. Senator, that is what we are looking at. I think it really comes down to the question of whether there should be an automatic termination at a certain percentage. We have been talking about 20 percent, because that is the guideline that has been utilized and required by the lenders in order to obtain a mortgage without there being PMI. If there is less than a 20 percent downpayment, PMI must be obtained.

Now, I think in our next panel we are going to hear from the PMI people and the people who actually make the mortgages, who want to tell us about what protection they think they need, and I think that is important.

It seems to me, though, that, number one, we should establish quite clearly that nobody be forced—and they are literally forced; if they can't get a mortgage by making a 20 percent downpayment, the difference is signing a lifetime contract, lifetime being until the mortgage is totally paid—to take that PMI and have no right to cancel out irrespective of the value of the home going up, and irrespective of the amount of money due and owing on the mortgage.

That simply is intolerable, and of course people are denied that choice if they are faced with a situation where either you sign this or you do not go to closing. So, effectively, that is not a choice.

I think the lifetime of the mortgage provision is something that certainly it would seem to me we should outlaw and ban.

Number two, the question is then under what process would you, if you just provided notice, start the cancellation? I am thinking out loud, but should there be some reasonableness test, and should it be automatic if you hit that point?

Should a lender be protected under extenuating circumstances, as a number of my colleagues point out, a fall or a decline in the value, or depreciation of the home as a result of it not being taken care of, et cetera? Under those circumstances, I think certainly lenders should have the right to raise objections, to raise reasonable objections.

But I have to tell you, once the insurance is no longer necessary, people should be provided with the opportunity, at the very least, to opt out. It seems to me that, unless there are extenuating circumstances, that should be automatic. That's something which we will consider.

I want to thank all the panelists for their testimony and for coming here to make known their views and for sharing them with us. Ms. Meier, if you or anyone else has any additional information, we would be pleased to receive that because we will be looking at these areas.

Thank you so very much.

Ms. MEIER. Thank you.

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Mr. NICHOLSON. Thank you, Mr. Chairman.

Mr. MORRILL. Thank you, Mr. Chairman.

The CHAIRMAN. We will now call our second panel.

The first opportunity to speak to this issue will be given to the Mortgage Insurance Companies of America. Next, we hear from the Mortgage Bankers Association of America, followed by America's Community Bankers, and finally the National Association of Federal Credit Unions.

Gentlemen, we want to thank you for your patience and for coming in today.

Mr. Lacy, before we get started, I want you to take some comfort in that you have heard, I think, every single Senator indicate that we understand and appreciate the nature and the opportunities that PMI provides to the American buying public. I just thought I would touch on that again. That is indisputable.

Mr. LACY. Thank you.

The CHAIRMAN. Mr. Lacy.

## OPENING STATEMENT OF WILLIAM H. LACY CHAIRMAN AND CHIEF EXECUTIVE OFFICER MORTGAGE GUARANTY INSURANCE CORPORATION ON BEHALF OF MORTGAGE INSURANCE COMPANIES OF AMERICA

Mr. LACY. Good morning, and thank you very much for allowing me to be here to talk about our business and how it works. I am representing the Mortgage Insurance Companies of America.

Mr. Chairman, I wholeheartedly agree that no homebuyer should pay for insurance they do not need. It is simply not good business, and that is not the way we run our business. My industry fully supports the initiatives which have been taken here to look at the cancellation process, and I am optimistic that by working together we can come up with very good legislation.

I would like to explain how our product works. I think sometimes we can get ahead of ourselves a little bit and there can be some confusion.

The value added is the fact that someone can buy a home with less than a 20 percent downpayment. In this example, we have a $100,000 home purchase price.

[A chart is shown.]

Currently, those are the types of loans we insure. Our average loan balance last quarter was $117,000. So we are talking a home purchase price of $100,000. We are talking about someone buying it with as little as 3 to 5 percent down. I used, as an example, the 5 percent downpayment here, so now we have a $95,000 mortgage amount taken back by the lender, and in this instance my industry would insure the top 30 percent of the mortgage, covering that top portion.

The important point here is that the lender and investor still have exposure. That is something that we have to keep in mind. One of the great things that has happened in the country is the flow of funds to housing, particularly affordable loans. These monies come not only from Fannie Mae and Freddie Mac, but they come from pension funds, they come from all sorts of very, very important sources. You can see there is a shared-risk concept here.

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It is not that we insure the entire mortgage, those lenders and investors do have exposure.

The product has worked marvelously well. We have really had a lot of growth because of the demand for it, and that is a very, very real thing that we are very proud of. At the same time, we do not want to see people paying premiums that they do not need to pay, and we will talk more about that I am sure.

I bought my first house with private mortgage insurance in 1972. I happened to be working for MGIC at the time, making $12,000 a year. I had just started working. We had our first child. I bought a $45,000 house. I was able to sell it 4 years later when the third child came along, and get a bigger home. Had I missed that first purchase, the value of the home would have moved far ahead of me in terms of my income. I could not have gotten there. I know how it works. I was out of that one after 4 years.

Our industry has been in business for 40 years. We have enabled 17 million people to buy homes with mortgage insurance. Today, we have 5 million policies in force. I think that is a very important point. The fact of the matter is that there are 12 million policies that are no longer in force. They have either canceled, they have refinanced, or they no longer exist.

My industry fully supports—fully supports—the disclosure to the homebuyers of their rights, and we do want to make sure that no one misunderstands or is later ill-informed about what they are getting. When the loan is made, I believe there should be full disclosure.

Second, we believe there should be annual notification, giving the borrower a further understanding of his or her rights.

Third, the legislation that we do bring forward needs to be flexible. I want to caution all of us not to rush in with hard and fast rules. The fluid flow of money into the secondary mortgage market is critical.

We talked earlier about the 80 percent loan-to-value ratio as a cancellation point. I would tell you that just last year alone my industry insured some 17,000 mortgages at 80 percent loan-to-value at origination.

Looking at those loans, you will find they are on properties that may have been two to four units, in some parts of the country, duplexes where people live in one part and use the other for income. Many of these loans were made by people of weaker credit. We had people who had problems who could not have gotten a loan without that flexibility. That is an important feature. We need flexibility. I am confident that the industry working together will be able to get this done.

Fannie Mae introduced something here, as I mentioned, in their testimony which I read this morning, which I applaud. It seems to be a well-balanced approach, and I think they will be fleshing that out further in coming weeks.

I am very confident that we can get the job done, and I thank you very, very much for letting me be here.

The CHAIRMAN. Thank you.

Mr. McCord.

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## OPENING STATEMENT OF RON McCORD, CMB, PRESIDENT AMERICAN MORTGAGE AND INVESTMENT COMPANY OKLAHOMA CITY, OKLAHOMA, ON BEHALF OF THE MORTGAGE BANKERS ASSOCIATION OF AMERICA

Mr. McCORD. Thank you, Mr. Chairman.

Mr. Chairman, Members of the Committee, I am Ron McCord, President of American Mortgage and Investment Company of Oklahoma City. I am currently serving as President of the Mortgage Bankers Association of America.

MBA appreciates the opportunity to appear before the Committee and to comment on S. 318, the Homeowners Protection Act of 1997. We commend you for holding these hearings and for your continued leadership in this area. We are committed to continuing to work with you and the Committee to seek ways to keep the costs of homeownership at reasonable and affordable levels for the country's homebuyers.

MBA supports the underlying objectives of your bill. However, we believe it is important to provide a fuller explanation of the nature of the mortgage process as it relates to S. 318. We are concerned that legislation as drafted may create unintended operational or administrative problems that could undermine your objectives and impose unnecessary costs and burdens on mortgage lenders and servicers.

There are numerous players in the mortgage process: mortgage bankers, secondary market investors, and mortgage servicers. As you are aware, mortgage bankers make loans to borrowers and retain them only long enough to pull the loans together for sale to investors, or for sale on an individual loan or flow basis. Accordingly, mortgage bankers are subject almost exclusively to the criteria imposed upon them by investors and the secondary market. This criteria includes making private mortgage insurance, or PMI, a requirement on loans with downpayments of less than 20 percent. Thus, due to the nature of the mortgage banking business, the decisions regarding the status of PMI and its cancellation rests with the investors in the overwhelming majority of the cases.

MBA feels that the Committee needs to move cautiously if it intends to mandate specific disclosure requirements at the time the transaction is consummated. In most cases, this type of specific requirement cannot be accurately complied with. It is often difficult to assert at the consumption of the transaction which secondary market guidelines will apply, and thus to determine the specific requirements for cancellation of PMI.

This results from the fact that the originating mortgage banker may not have selected which investor will purchase the loan at the time of closing. Thus, the originating lender will not necessarily know which guidelines will govern that loan.

This is one of the largest problems we have in complying with the legislation as it is currently drafted.

The mortgage servicer is another vital player in the mortgage process. The servicer is the party to which the payments are sent, and with whom the borrower has the most frequent and direct contact. In some sense, servicers actually serve two masters: the investor and the borrower. Regarding the investor, the servicer has a contractual responsibility to the investor to protect the collateral.

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This is formalized in a contract between the two parties. Although the servicer's relationship with an individual borrower is not legally formalized, the servicer, nonetheless, does act in a manner similar to a trustee in that they are responsible for collecting the monthly mortgage payments and remitting principal and interest to investors, as well as the proper amounts for hazard insurance, taxes, and private mortgage insurance premiums to the appropriate parties. Functionally, servicers act as a gatekeeper for private mortgage insurance. They collect premiums for an indefinite period on behalf of the mortgage insurer, and receive absolutely no fee income for providing this service.

It is important to note that mortgage servicers are often national companies. For example, the largest servicer in the country services loans from all 50 States and the U.S. Territories. In the course of its business, it deals with about 433 different investors and services approximately 1.5 million loans annually. Each investor has different requirements for PMI cancellation. There are simply too many sets of different rules and procedures for a servicer to track with any specificity.

Creating different computer data bases for each individual investors' requirements would not only be prohibitively expensive but impossible to achieve.

It is very important to remember that servicers are merely the intermediaries in this process, and have no authority to modify the pre-conditions established by investors or insurers for mortgage insurance coverage. As such, we believe that the mortgage insurance companies and the investors must be required to bear substantial responsibility and the potential liability for administering this new regime.

Further, we must note the fact that the automatic cancellation requirement—and we believe there is such a requirement in the bill—may be difficult for mortgage servicers to administer as currently drafted.

The CHAIRMAN. What should we do? You have created in your testimony, in a rather short period of time, the fact that we should continue this absolutely ridiculous system which gives nobody any notice and has people signing up for the lifetime of the mortgage. All you are doing is trying to say: Make sure we do not incur any additional cost.

But what about the hundreds of millions of dollars, Mr. McCord, hundreds of millions of dollars annually that people are paying and getting no benefit from?

Have you seen that at all?

Mr. MCCORD. Mr. Chairman, we——

The CHAIRMAN. I have to tell you, your testimony, as I see it, is one of extreme convolution. It would have us say we are going to just continue with business as usual.

Now, you understand that we do not want unnecessary burdens; I have heard that for years. But either you recognize the problem in this, or you don't. You have not addressed that at all. Is there any problem that exists today?

Mr. MCCORD. Mister——

The CHAIRMAN. Is there any problem that exists today?

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Mr. McCORD. Mr. Chairman, yes, there is a problem that exists today.

The CHAIRMAN. Oh? Wonderful.

Mr. McCORD. And if I may comment——

The CHAIRMAN. Yes, I would like to get to that. Do you have a suggestion as to how to do something, instead of saying, hey, by the way, we don't know who should be doing what, who should send the notice, but we don't want to incur any cost?

I understand, but people are paying $20, $30, $40, $50, $60 a month for years and years beyond the pale. I found Mr. Lacy's testimony refreshing coming from the industry.

Go ahead.

Mr. McCORD. Mr. Chairman, we are——

The CHAIRMAN. Put more time on that clock.

Mr. McCORD. Mr. Chairman, we are for disclosure, and we are for automatic cancellation.

The CHAIRMAN. Really?

Mr. McCORD. If, as the mortgage servicer, the continued liability that we have to the investor is also terminated, because we receive no premiums from the mortgage insurer, and we receive no benefit as servicer for the investors such as Fannie and Freddie.

The CHAIRMAN. I am glad I asked the question. I understand now that you are for automatic termination at some point.

Mr. McCORD. Yes, sir.

The CHAIRMAN. Good.

Mr. McCORD. Thank you.

Senator FAIRCLOTH. Mr. Chairman.

The CHAIRMAN. Senator Faircloth.

Senator FAIRCLOTH. Would you repeat that? I didn't quite follow it. You are for automatic termination?

Mr. McCORD. As a mortgage servicer, we receive no benefit from the mortgage insurance premiums, no benefit because we are not the holder of the note; we are simply the gatekeeper. We collect the premiums and remit them to the appropriate parties.

Senator FAIRCLOTH. Where do you make your money?

Mr. McCORD. We make our money on servicing the loan. We do not make our money on collecting private mortgage insurance premiums on behalf of the mortgage insurance industry.

Senator FAIRCLOTH. What do you make your money on?

Mr. McCORD. We make our money as a servicer on servicing the loan for the investor, Fannie Mae, Freddie Mac, or others——

Senator FAIRCLOTH. OK. So you get a percentage for handling the loan.

Mr. McCORD. That is correct. And we get no additional money whether the loan is insured or not insured. It is an extra burden and administrative cost that we bear as an industry to help enhance homeownership in America.

Senator FAIRCLOTH. Thank you, Mr. Chairman. I simply did not understand.

The CHAIRMAN. Mr. McCord, the fact of the matter is, you are saying we do not want to pick up the cost; right? You are not disputing what should be done, are you?

Mr. McCORD. No, sir. It is just that as a servicer who receives no benefit——

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The CHAIRMAN. OK. Then let's ask you something else.

Who is in the better position to know where the people live, and what the payment is? Yourself, perhaps the originator of the mortgage? Who? The PMI people?

Mr. MCCORD. In the case of most of the loans that are on the books, it is the mortgage insurance industry who has the data which can tell the mortgage servicer when that loan has paid down to that 80 percent level.

The CHAIRMAN. But don't you know automatically, from the first day, so that you can say at the end of 13 years, and this takes 13 years, the loan has been paid down to that 80 percent level? It is not a very difficult thing to program into a computer so that the information comes right up.

Now, if there are any additional costs, obviously the question is whether the PMI should bear them at that point in time, but you are talking about costs which are not very significant whatsoever. Is that not true?

Mr. MCCORD. Yes, sir.

The CHAIRMAN. OK. So this is not a very difficult problem, if we wanted to look at it.

Again, it simply ends up being X number of years from the time of the origination of the mortgage. Now, if there are circumstances that are different, the mortgagee will inform you. They will inform you that, by the way, there was something which took place along the way, et cetera.

But it would seem to me that your industry is uniquely positioned to have that data base.

Mr. MCCORD. Sir, if I may——

The CHAIRMAN. Yes.

Mr. MCCORD. —the industry is not uniquely positioned——

The CHAIRMAN. OK.

Mr. MCCORD. —because we have not had those mandated guidelines. Our systems——

The CHAIRMAN. You are worried about cost, and I understand that——

Mr. MCCORD. Sure.

The CHAIRMAN. —but you agree with the principle. You are simply saying, just do not stick us with the cost?

Mr. MCCORD. The cost, and also the burden of disclosure of information that we do not have currently in our system, that one of our partners, the mortgage insurance industry, does have.

The CHAIRMAN. OK. It would seem to me, as part of the legislative process, you should be given that information, right, from the origination?

Mr. MCCORD. That is correct.

The CHAIRMAN. And if this legislation was enacted, you would be getting that information.

Mr. MCCORD. If we can obtain that information, because we have direct contact with the servicer, we will be more than happy to disclose as a servicer would with the borrower; absolutely.

The CHAIRMAN. All right. Thank you.

Mr. Sutkowski.

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## OPENING STATEMENT OF FRANK J. SUTKOWSKI CHAIRMAN, SECONDARY MARKET SUBCOMMITTEE AMERICA'S COMMUNITY BANKERS, WASHINGTON, DC AND SENIOR EXECUTIVE VICE PRESIDENT & CHIEF LENDING OFFICER, LIBERTY BANK MIDDLETOWN, CONNECTICUT

Mr. SUTKOWSKI. Good morning. My name is Frank Sutkowski, and I am appearing here today on behalf of America's Community Bankers. I am Chairman of ACB's Liaison Task Force with Fannie Mae and Freddie Mac and have been engaged on the issue of the timely dropping of mortgage insurance coverage for both ACB and my own institution.

I am Senior Executive Vice President and Chief Lending Officer for Liberty Bank of Middletown, Connecticut. Liberty Bank is a $1.2 billion mutual form institution, which makes it middle-sized nowadays. Liberty Bank is active as a real estate lender in both the primary and secondary markets.

Let me begin by commending the Chairman and this Committee for addressing the issue of how to ensure that borrowers pay only for the insurance coverage they need on their loans. ACB members have no stake in keeping PMI in force longer than necessary for either portfolio or service loans.

My own institution currently has an ongoing program that notifies borrowers when we believe that PMI can be safely dropped. We go through continuous portfolio review to ensure that we alert customers when, through either regular loan amortization, special principal paydowns, or property price appreciation, that PMI coverage can be dropped.

We do have to recognize that PMI coverage deals with a special threat. Unfortunately, the real estate market values do not always move up. On both coasts, in California and Connecticut, property values took a sharp correction and only recently is a solid recovery taking hold. My institution still can show more loans than we would like with 5-year seasoning and upside-down values, where the current property value is less than the original sales price.

Though we must deal with the risk of value drops, we have found that the normal driving force for most early improvement in loan-to-current-value ratios is property price appreciation. Of course, even in healthy markets, it will still take some time to bring a 95 percent loan down to the 80 percent level, where lenders can feel comfortable with PMI termination.

ACB particularly appreciates the sensitivity that you demonstrated, Mr. Chairman, when you introduced your bill, S. 318, to the legitimate role of this insurance coverage.

I can offer only a few comments on S. 318 here, reserving the rest for my prepared statement and its attachments. I would like to note that we do have to consider adding safeguards that the loan-to-current-value ratio has gone down as much as the loan-to-original-value ratio. With regular amortization, a long enough period will normally elapse for the upside-down situations to correct themselves, but the situation may differ in cases where significant partial prepayment has been made by the borrower.

ACB and others have been addressing complexities like this in fruitful discussions with Fannie Mae. Those discussions have also

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raised the possibility of an approach where an automatic lender-investor waiver of the continuation of PMI would be triggered by the passage of half the loan's scheduled maturity.

Both sides of the loan transaction would also benefit from user-friendly and efficient notification of PMI cancellation options.

ACB, however, is concerned that the required frequency of notices under S. 318 may confuse rather than help customers. There is an obvious case for supplementing up-front disclosure with periodic reminders. On the other hand, the literal language of S. 318 would require many lenders to make monthly disclosures, starting with the first regular monthly payment.

The alternative requirement in S. 318 that the notice be no less than annual would be a more practical approach and enable coordination with annual reports to consumers such as the Federal tax information returns and escrow analysis. Borrowers will tend to pay more attention when they are given a "heads-up" that they can really use rather than monthly notices that tell them they still have a long way to go.

ACB also applauds the motivation behind the provision in S. 318 that deals with the cost of added notices. As a practical matter, it would still be difficult for a lender-servicer to pass the cost of existing loans to the PMI carrier under existing contracts. Economizing on costs by making the notices visible enough to be useful to the consumer and targeted enough to be manageable on the business side is the best way to go.

As my prepared statement points out, it is not just a trivial task to handle the real world process of notifying customers that price trends have made it worth their while to check on whether reappraisal can justify dropping their PMI.

My institution is willing to be flexible to help a good customer. If the appraisal produces a loan-to-current-value ratio a fraction away from the target ratio, for a customer with a good payment history in a reasonably sound real estate submarket, we will often let the PMI be dropped to avoid the appraisal fee being wasted and both ourselves and the borrower having to go through the exercise again in 6 months or so. We can offer this flexibility as a portfolio lender. When we have sold the loan into the secondary market, as only the servicer we have to work under the investor's standards. This is why we have been eager to work with the GSE's.

As lenders and servicers, ACB members find that to deal with most PMI cancellation requests from customers we have to look at property price appreciation. The average loan life is less than the period required to bring the loan-to-original-value below the termination threshold by regular amortization of the loan. Accordingly, ACB has been engaged in private sector efforts, especially with Fannie Mae, to address this topic in a truly comprehensive way.

ACB is truly committed to resolving this issue to the satisfaction of the public and of Congress. We welcome continued Congressional oversight of the lending community's efforts to produce a private sector solution to standards that actually go well beyond the situations covered in S. 318. ACB recognizes that industry efforts must come to fruition very quickly. Legislation early in this Congress is always an option, and the industry approach, to qualify as an acceptable alternative, has to do more. The public deserves no less.

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Thank you for this opportunity to offer our views on this important topic. I would be happy to discuss any questions that you have about our position.

### OPENING STATEMENT OF BRIAN L. McDONNELL PRESIDENT/CEO, NAVY FEDERAL CREDIT UNION VIENNA, VIRGINIA

Mr. McDONNELL. Good morning. My name is Brian McDonnell. I am the President and Chief Executive Officer of Navy Federal Credit Union. I'm here today to represent the views of the National Association of Federal Credit Unions (NAFCU), the Credit Union National Association (CUNA), and the Navy Federal Credit Union. I am also here to express the views of the thousands of other credit unions represented by NAFCU and CUNA for the proposed Homeowners Protection Act of 1997, S. 318.

Mr. Chairman, Navy Federal, NAFCU, and CUNA applaud your efforts and those of Representative Hansen in introducing legislation which clearly informs existing and future homeowners that private mortgage insurance, PMI, may not be required for the full term of the mortgage contract. Our experience has shown that PMI cancellation requirements are confusing to many members, despite our best efforts to disclose these requirements. We believe that this legislation will increase the awareness of many of our members and millions of other homeowners who mistakenly have taken for granted that PMI premiums are required for the life of the mortgage loan.

Since we initially began offering mortgage lending services to our members in 1979, Navy Federal has provided over 110,000 mortgage loans, totaling $12.6 billion, to help our members realize their goal of homeownership. Currently, we service over 63,000 mortgage loans, valued at $6.2 billion. We provide mortgage lending service on residential properties located in all 50 States and the District of Columbia.

Because of the requirements of the purchasers of Navy Federal's mortgage loans, we require PMI coverage when the member provides less than a 20 percent downpayment. As you probably know, mortgage lending industry data clearly shows that the lower the downpayment, as a percentage of the property value, the greater the risk of the loan to default. PMI fulfills a critical need, both for many first-time homebuyers, as well as for the members who have low-to-moderate incomes and limited resources to apply toward a downpayment for a mortgage loan. Without the availability of PMI, these members would be unable to obtain conventional mortgage loans to finance the purchase of a home.

Although we sell our loans to secondary market investors, we always retain the servicing of the loans. The total PMI premiums collected from our members are passed directly to the PMI companies. We receive no administration fee from the PMI companies.

We are sincerely concerned about saving our members money and protecting their interests, as well as protecting our investors. Therefore, it has been our policy to monitor the outstanding loan balances of our members' loans with PMI to ensure that they are not paying for PMI coverage when it is no longer required. This typically means that once the loan balance represents 80 percent

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or less of the original value of the property, Navy Federal automatically cancels the PMI on behalf of our members. We do not send a notice to our members requesting approval to cancel the insurance; we simply cancel it, adjust our payments, and notify our members by mail that the PMI is no longer necessary and has been canceled. We have been automatically canceling PMI for our members since we began offering mortgage loans in 1979. At present, we cancel about 40 PMI premiums and loans per month as a result of monitoring our members' outstanding principal balances.

You may wonder why we do this. The first, and most important, reason is that we are a credit union dedicated to serving the needs of our members. We look for ways to repay the loyalty of our members by offering them low rates on loans, competitive rates on savings accounts, responsive and convenient service, and limiting the fees charged to members.

We believe that when the member obtained the mortgage loan with PMI from us, we struck a bargain with the member regarding the PMI requirement. The member understood that PMI was required because the downpayment was less than 20 percent. When the accumulated equity in the property reaches that 20 percent, we think the members expect their credit union to cancel the PMI.

In summary, Mr. Chairman, Navy Federal, NAFCU, and CUNA support your Act. We would recommend clarification of some of the technical definitions incorporated in the bill, but this is basically good legislation which will save homeowners money without jeopardizing the mortgage lender. We hope the legislation can be kept simple for lenders and PMI companies to implement and, therefore, easy for the credit union members to understand. The credit union movement stands ready to provide assistance to see that this legislation becomes law.

Mr. Chairman, this concludes my opening statement. Again, I wish to thank you on behalf of Navy Federal, NAFCU, and CUNA for the opportunity to express our views on this legislation. I look forward to answering any questions you might have.

The CHAIRMAN. Thank you, Mr. McDonnell.

Let me ask the entire panel: Do you believe that annual private mortgage insurance should be required for the life of the loan?

In other words, presently there are contracts which people enter into that bind them to pay PMI for the life of the loan, not withstanding the fact that they have achieved 20 percent, 40 percent, 60 percent, 80 percent—the only time they are allowed off of the PMI is when they get to 100 percent of the loan.

Do you believe that should be a requirement? Or should we not perform that?

Mr. McCord.

Mr. MCCORD. I believe when the life-of-the-loan issue was first originated in our industry, it made sense because we did not have the technology, we did not have credit scoring, we did not have the ability to automatically appraise on a collateral assessment-type basis.

Times have changed. I do believe it is very appropriate today to address that issue and to not require it on a life-of-the-loan basis.

The CHAIRMAN. To prohibit it?

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Mr. McCORD. Not to prohibit it. I think to look at it on an individual basis makes sense, but to allow the borrower to exit that, or to terminate it if the circumstances merit.

The CHAIRMAN. Suppose somebody paid 50 percent of the mortgage. Should they be allowed to exit it?

If you have a contract that you have signed which binds you to the completeness—even if we were to pass this bill as it is, I do not know how many people—and I am going to ask Mr. Lacy if he has an idea—how many people are bound by this lifetime provision, this lifetime-of-the-loan provision.

Mr. McCORD. I am sorry, I misunderstood your question.

The CHAIRMAN. I am asking you, as a matter of public policy, do you think that people today—and I understand how it is that this took place initially, getting experience, et cetera—should be bound to the lifetime of the loan?

Mr. McCORD. No, I do not.

The CHAIRMAN. OK.

Mr. Lacy.

Mr. LACY. No homebuyer should pay for insurance that they do not need, clearly. We have to decide at what point in time is it appropriate to terminate that insurance.

The CHAIRMAN. Yes, when should they have the right to terminate, or when should that insurance be no longer necessary so they can opt out.

Mr. LACY. Sure. And, Senator, I think that is a real issue for the investor and the lender, depending upon where that mortgage goes, and where the money comes from, if it goes in a mortgage-backed security, or to the portfolio of Fannie Mae and Freddie Mac.

My experience has been that clearly Fannie Mae and Freddie Mac have really tried to do the right thing. We are seeing that again and again in trying to figure out the best way to do this.

The CHAIRMAN. Let me ask you, if you know, can you give us an idea as to how many of those PMI's are in existence out there?

I know you indicated there are 5 million policies that are still in force, where people are still paying, and let's say they are bound to this lifetime loan provision.

Do you know how many that might be?

Mr. LACY. I do not know that number, but I think you will be somewhat surprised to learn that the average life of a policy that we issue is 5 years.

In fact, as I look at the portfolio in the industry, those 5 million loans, we estimate that under 5 percent of those loans could be candidates for cancellation.

The CHAIRMAN. Is that right?

Mr. LACY. Yes, sir. The reason for that is, if you look at the numbers, since 1992 our business volumes have been very, very big.

The CHAIRMAN. Yes.

Mr. LACY. In fact, in the in-force Book of Business, almost 90 percent of the business that we have insured today was put on the books since 1992.

The CHAIRMAN. Yes.

Mr. LACY. I think perhaps some of the other lenders can speak to how long a loan will stay out there. We looked at some of these

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contracts. We went 10 years and beyond, and we looked at loan-to-value ratio.

Then, looking at that 5 percent, I also looked at some of the coupon rates and I was surprised. I asked myself the question: Why hadn't these people refinanced?

Why hadn't these people moved out of that particular mortgage transaction? Because back in 1986, interest rates were 11 to 11.5 percent.

I can only speculate. I do not know. Maybe Ron could comment. Perhaps we have some collateral under water. Perhaps some of the properties may not appraise out. I do not know.

It is surprising that people did not refinance out.

The CHAIRMAN. OK.

Mr. Sutkowski.

Mr. SUTKOWSKI. No, I do not believe it should be paid over the lifetime of the loan. I believe it should be paid over the period of exposure when the bank or the mortgage company is exposed.

Typically we have taken the position, and most of the ACB members have taken the position that they have, to basically handle the relationships with our customers. We are interested in doing other things with the customers, so we show that we care, as well.

The CHAIRMAN. Let me ask you this. As a rule, you don't require PMI for an individual home, or an individual homeowner, if they have a 20 percent downpayment.

Is that correct?

Mr. SUTKOWSKI. That is correct.

The CHAIRMAN. So would it not therefore follow if they have paid 20 percent of that mortgage they would be a candidate to opt out?

Mr. SUTKOWSKI. Typically I would agree. However, coming from Connecticut where we have had——

The CHAIRMAN. We understand the special circumstances where there is a decline in the market. We have seen that. In our legislation we have indicated we would provide for that.

In other words, providing you have a situation where, as the mortgagee, you can say, look, we would love to let you out, but the property value has gone down in the entire region.

But as a starting-off point, would 20 percent not be a number that you would look at?

Mr. SUTKOWSKI. Twenty percent is a comfortable figure.

The CHAIRMAN. Mr. McDonnell.

Mr. MCDONNELL. Absolutely not. When you take out a 90 percent long-term-debt loan, it takes 9 years to pay that down to 80 percent at a 7.5 percent rate; 9 years of demonstrated payment is enough to show anyone that they are going to pay a loan back, and I think it should not be continuous.

The CHAIRMAN. OK.

Senator Dodd.

Senator DODD. Thank you very much, Mr. Chairman.

I should have mentioned to you at the outset that I would like you to include me as a cosponsor of the bill.

The CHAIRMAN. I thank the Senator.

Senator DODD. Mr. Sutkowski happens to be a neighbor of mine up the Connecticut River. It is a pleasure to have you before the Committee today.

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If anyone questions the value of or whether community bankers play a pivotal role in the country, I think the fact that ACB does follow a practice here is one of the advantages consumers have in dealing with a community bank, and I commend you for your work.

Mr. SUTKOWSKI. Thank you.

Senator DODD. The point Mr. Sutkowski was making, Mr. Chairman, is that we have been through a dreadful period in Connecticut, and to some extent maybe in New York as well, but certainly in our State we had a collapse of that real estate market.

We had a lot of people aggressively entering the real estate market in the mid-1980's, when prices had been inflated substantially, then, within a matter of months, reality set in and we had a lot of people sitting with property paying mortgages on values that were not even remotely close to what current value was.

It is creating a real dislocation problem. We are coming out of it, as Mr. Sutkowski pointed out, but that can happen.

We have raised this issue in a lot of subject matters that have been talked about here, one being the balanced budget constitutional amendment. We talk about national economic crises, and that can happen. But more than likely in the future it is going to be regional crises of one kind or another, where the Nation does not feel at all equal all the time.

How do you respond to more regional dislocations?

What we went through in the Northeast, particularly in Connecticut, Massachusetts, and to some extent I think in Rhode Island as well, is a good example of what I think we are more likely to see down the road. You are going to be faced with these situations as they come up. I commend all of you for your testimony today.

Let me just ask one question. One of the reasons I like this bill, Mr. Chairman, and I do think there are legitimate questions, is that it is easy enough when you are holding onto the property for X number of years, to get to where you have paid in the required percentage to terminate the insurance, and that's it.

But I suspect there are an awful lot of homeowners who are like Mr. Lacy, who start out as a first-time homebuyer, get into it, then move on pretty quickly, without holding on to the property for the length of time that would trigger the end of the necessity for the insurance. Then how do you make that determination?

That's the more dicey question, it seems to me, especially when you are selling these in secondary markets.

We receive complaints all the time from constituents who call in and ask: Who do I talk to? I called my bank and they do not have my mortgage any longer. Who am I talking to here? Who owns my mortgage? I am very interested in how we might resolve that issue.

One of the provisions I like in this bill is that it not only affects homeowners that will take out private mortgage insurance after this bill is enacted, but it goes back and protects consumers that are presently in the situation.

I wanted to ask all of you here whether or not you support that provision of the bill which would cover existing mortgage holders. Arguably, I guess, in some cases people bought in when the rules were different, but do you support applying the provisions of this bill to the existing mortgage holders?

Mr. Lacy.

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Mr. LACY. I believe in the principle. The issue is going to be with the secondary market investors that have bought those mortgages and their expectations, and we do not want to disrupt that.

Senator DODD. No, I understand that. But do you support that?

Mr. LACY. I believe that any time we can get someone off the insurance, we should, clearly, if we do not need it.

Senator DODD. Mr. McCord.

Mr. MCCORD. Absolutely we support it. Again, just in addition to Mr. Lacy's comments, it is going to fall upon the secondary investor and what those guidelines are.

As the servicer, we would certainly support that.

Senator DODD. I gather you do, Mr. Sutkowski?

Mr. SUTKOWSKI. There is no question we support it. I think it is practically good business.

The CHAIRMAN. Do you approve, Mr. McDonnell?

Mr. MCDONNELL. Yes, we support it, as well.

We get a monthly printout which shows the original appraised value and the present balance, and it is not rocket scientist stuff to figure out what the loan-to-value is.

Senator DODD. That is the point the Chairman made. What we are talking about is not heavy-duty math here.

Finally, the point that I was raising, and maybe I will start with you, Mr. Lacy, that issue of making the appraisal. How difficult is that to do?

The Chairman suggested, and I agree with him, that this is not terribly hard to figure out. We figure it out all the time. In fact, you figure it out, Mr. Sutkowski, all the time. You are extending loans and trying to figure what the value is.

People want to borrow on a mortgage, and you try to determine the value of that property in order to know whether that additional loan off the home is going to be reflected in what the market is bearing.

The CHAIRMAN. I have done it myself recently.

Senator DODD. We all have done it.

[Laughter.]

Mr. LACY. Senator, I believe so much in your comments——

Senator DODD. A couple of our colleagues do not have to do it, but you and I do, Mr. Chairman.

The CHAIRMAN. I had to pay that student loan off for my son.

[Laughter.]

And I had to re-mortgage.

[Laughter.]

Mr. LACY. Senator, your opening comments I thought were excellent about disclosure. If the consumer knows what the facts are, what is going on, economic man will act in his own best interests.

Senator DODD. Right.

Mr. LACY. We just need to be sure we get that information to them.

I do want to comment, though, that in the portfolios we have insured, we will see losses after 10 years of a term of a mortgage. Actually, 20 percent of the lost development actuarially will fall beyond that tenth year. I just want to make it real clear that there is some risk here, and we have to be very, very careful not to disrupt our flow of funds from investors.

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That is where we need to be thoughtful, and counsel with them. I like very much what Fannie Mae put on the table here this morning in their testimony. I like their principles——

Senator DODD. That is a very good point you make, because I can see here where we can pass S. 318 and business practice there will just be a premium added on to the cost to consumers in order to hedge against that situation you have described.

Mr. LACY. There will be losses after 10 years, and we just have to be careful that we do not hurt our marketplace.

Mr. MCCORD. Absolutely. As I have said before, we are all in favor of disclosure. I think there are those circumstances, though, which are unique to the marketplace that we will need to work through as a partnership not only with the mortgage insurance industry but with those investors as a mortgage servicer.

We are prepared to do what is right for the consumer, it is just the cost and the burden of disclosure that we want to make sure our industry does not face.

Mr. SUTKOWSKI. We do disclosure as a matter of State law in Connecticut. The bank has disclosed for about 10 years.

I would be concerned about the appraisal because, as it relates to an appraisal, we may be looking at reappraising the property at a time when property values are going down.

The flip side is also true, that property values may go up, so it may be that, in a very vibrant market, within 3 or 4 years the insurance can be dropped. We have seen that in Connecticut in a very meaningful way.

The appraisal is a cost of doing business. Typically it is made up roughly in 4 or 5 months of insurance premium, but it is a worthwhile investment on the part of the customer.

Mr. MCDONNELL. I believe there should be initial disclosure, and I believe there should be an automatic cancellation provision unless, as Michelle Meier was referring to, and possibly an annual statement which explains to those people that have not quite hit the 80 percent loan-to-value the circumstances under which they can eliminate the PMI.

Senator DODD. I mentioned the frustration that some consumers have when mortgages get sold, who is holding it and the like, but I do not want those remarks to in any way indicate lack of support for the tremendous job the secondary market does and what the world would be like without them.

Mr. MCDONNELL. Thank you.

Mr. SUTKOWSKI. One thing I might add, while 80 percent is an acceptable business risk, on investments in second homes typically the secondary market requires 70 percent because people have a tendency, perhaps if there is some difficulty, not to treat the transaction the same way as they would with their own property.

It is this 70 percent for investment in second homes that is a real concern to be considered.

Senator DODD. Thank you.

Mr. Chairman, I thank you.

The CHAIRMAN. I want to thank all of our panelists. I want to thank Senator Dodd for coming on as a cosponsor. I want to say that right up to the end of this hearing we have heard some very interesting and I think constructive suggestions.

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The question as it relates to second homes, for example, whether that should be allowed, I think is an excellent point. Should there be a differentiation? I think there probably should be. We will ask our people to take a look at that.

We will be, obviously, and have been consulting with Fannie Mae and Freddie Mac. We will be looking at them with respect to what they suggest.

As I have indicated to you, we certainly do not want to leave the lenders out there in a precarious situation. Mr. Sutkowski, we do not want to have you in a situation where the market has collapsed and you are placed in a position where you now lose the protection that you initially had.

That is not what this is about. That is why I think we included that there be a flexibility and a determination made by the Federal Reserve.

Now maybe we can put more precise language in there and still maintain that flexibility. We have not—and I underscore this—we have not, for insurance purposes and whether there would be additional premiums or attached surcharges, et cetera, indicated that there would be any valuation taken in the rising market.

We have heard about falling markets because, in that case, I think we really get into a very tricky situation. Of course, if the lender feels so disposed, that is something he and the mortgagor can always decide. You might decide on your own, yes, we do not have any need for that and we can let you off, but I think that should at least be an option.

I do not think people should be tied to long-term or lifetime contracts, number one. I think there should be options given both to the lender and to the homeowner. I certainly do think the lender should have protection as it relates to a declining market if there are those exceptions, but that the basic rule of logic, it seems to me, which just about everyone has signed off on, is that if there is no longer a requirement for this protection and for these additional payments to be made, they should be terminated. The main question is how do we get there, and we are going to get there, believe me, we will get there.

That is where I think we should have a broad consensus, recognizing that we do not want to create additional burdens. But we understand that.

I want to thank Senator Dodd, and I want to thank the participants today and all of my colleagues. We stand in——

Senator DODD. Could I, just before we go, Mr. Chairman, make an inquiry?

The CHAIRMAN. Certainly.

Senator DODD. As I said, I thought the existing deal with the existing mortgage holders could mean a real difference to people pretty quickly.

The CHAIRMAN. I think even if we take Mr. Lacy's number—and I accept that—5 percent of 5 million, that is 250,000 people who—I am not suggesting that every single one of them could cancel, but if we use that 5 percent, that is 250,000 people who may be paying anywhere from $20 to $100 a month which they would be able to drop. If you figure that out on a monthly basis, we're talking about millions of dollars.

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If we can establish the guidelines, and that is what we are talking about legislatively, whereby these people will be able to opt out, I think that is important.

Senator DODD. Do you have any sense about how fast we will be able to move on a bill like this?

The CHAIRMAN. Judging from the comments of my colleagues, I think there is broad consensus. There is that concern that we give to the lenders the ability to deal with unique circumstances——

Senator DODD. I agree.

The CHAIRMAN. —of decline, or a crash in the real estate market, et cetera, and I think everyone agrees with that. But I would hope that we can bring this to markup within the next 60 days. Certainly, we should be able to work this out and move on this expeditiously here, and then send it over to the House.

Senator DODD. That would be great. Thanks.

The CHAIRMAN. Thank you.

We stand in recess.

[Whereupon, at 12:20 p.m., Tuesday, February 25, 1997, the hearing was adjourned.]

[Prepared statements, response to written questions, and additional material supplied for the record follow:]

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## PREPARED STATEMENT OF SENATOR ALFONSE M. D'AMATO

Good morning. Today the Committee turns its attention to an issue that could cost American homeowners millions and millions of dollars each year—I am referring to abusive charges for unnecessary private mortgage insurance. It has come to the Committee's attention that thousands of Americans who work hard to afford a house of their own are unfairly paying for private mortgage insurance, or PMI, long after the PMI policy is necessary. The practice of allowing current and future homeowners to pay for insurance that serves no useful purpose and accrues no benefit to the consumer must be stopped.

While I would like to welcome our entire panel of distinguished witnesses, I would particularly like to thank Representative James Hansen (R–UT), who has been *the* leader in the House in the fight to address PMI abuses. I am pleased to welcome representatives from the credit union industry, the mortgage bankers, the mortgage insurance companies, the community bankers, the realtors, the appraisers, and consumer advocacy groups.

I will present just one example of this unfair practice. A homebuyer purchases a $100,000 home with a 30-year, fixed-rate mortgage and a 10 percent downpayment. After 10 years and $3,500 in mortgage insurance premiums, it is likely that the homeowner would have a 20 percent equity stake in his or her home. At this time, private mortgage insurance is no longer necessary. However, if that homeowner is unaware of the right to cancel—as many are—and continues to pay for unnecessary insurance, he or she could spend an additional $7,000 in premiums over the life of the loan. And this is less costly than many of the horror stories we hear. In fact, private mortgage insurance rates average between $20 and $100 per month, meaning that some consumers are unknowingly paying from $240 to $1,200 a year for absolutely no reason. Situations like these are nothing less than a fleecing of the American homeowner.

Today we will closely scrutinize this problem. We are here to seek a fair and thorough examination of this complex issue. We are on a fact-finding mission. We have a right to know how pervasive this egregious practice is. I look forward to hearing from our witnesses so we can gain some insight on how widespread this injustice has become and how it can be rectified.

I would also like to refer my colleagues to Ken Harney's column in this past Saturday's *Washington Post*. Mr. Harney writes:

> An eye-opening new estimate of the extent of the problem came last week when a Dallas-based loan portfolio analyst said he believes that as much as one-fifth of some lenders' mortgage portfolios consist of PMI-insured loans with equities that are greater than 20 percent of current market resale value.

This article will be made part of the hearing record.

Let me make one thing clear before we move forward—PMI is a legitimate financial project that has helped millions realize their dream of homeownership. Private mortgage insurance plays an important and extremely useful role in the home mortgage industry. Generally, lenders require borrowers to purchase private mortgage insurance if the homeowner makes a downpayment of less than 20 percent of the purchase price. PMI has helped to provide the American dream of homeownership to more families while ensuring the safety and soundness of our home mortgage markets. PMI has allowed millions of creditworthy working and middle-class families to realize the dream of homeownership, even if they did not have the cash on hand to make substantial downpayments.

The bar graph which is displayed represents the number of households with mortgage insurance in 1995.

- Over 50 percent of insured mortgages originated in 1995 carried private mortgage insurance.
- This is in contrast to 32 percent insured by the Federal Housing Administration and approximately 14 percent guaranteed by the Veterans Affairs Department.
- The total number of mortgages in 1995 that carry PMI is 960,000.
- In 1996, the total number of mortgage originations with PMI had increased to slightly over 1 million, out of approximately 6 million mortgages.

Today's hearing will analyze legislation which I introduced on February 12, 1997, the Homeowners Protection Act of 1997 (S. 318). My legislation would allow future homeowners the right to cancel private mortgage insurance when it is no longer needed to protect the lender or subsequent owner of the mortgage from the cost of default. In most cases, this occurs when the homeowner has accumulated equity equal to 20 percent of the original loan value. With respect to current and future mortgages, S. 318 would mandate disclosure of cancellation rights to the homeowner

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on an annual basis. This legislation is a starting point—I am not assured that it goes far enough to effectively eliminate all unnecessary payments.

I would like to express my gratitude and appreciation to the broad spectrum of consumer and industry groups that have expressed their support for the principles of this legislation.

I plan to pursue this matter aggressively. I trust that the Committee can work to rectify the abuses that are occurring in a bipartisan manner. I hope for the entire Committee's support to ensure that not one unnecessary mortgage insurance premium is paid by an unsuspecting homeowner.

Thank you.

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## PREPARED STATEMENT OF SENATOR LAUCH FAIRCLOTH

Thank you, Mr. Chairman. At the outset, let me welcome some folks from North Carolina who are here with us today, especially Mr. Greg Barmore, Chairman of GE Capital Mortgage in Raleigh, one of the largest private mortgage insurers in the country. I would like to thank Mr. Barmore and the others for coming to hear the examination of this important issue.

Those of us here today already know what PMI is, but what appears to be part of the thrust of the Chairman's bill is that many homeowners who are paying PMI every month do not. Yet, they continue to pay for it well into the life of the loan.

The argument for the existence of PMI is without controversy. PMI allows a significant number of Americans to obtain home mortgages that would not have been able to put down the required 20 percent of a home's purchase price.

The problems the Chairman's bill attempts to correct are how to give homeowners notice of what is in the PMI contract obtained at their closing and who is to pay for that notice mechanism.

Let me state for the record that I support disclosure of a homeowner's right to terminate mortgage insurance, and I support that homeowner's ability to cancel the mortgage insurance once it has been determined that the insurance is no longer needed.

I realize there are some cases where there is no question that mortgage insurance could and should have been cancelable, but for whatever reason was not. We should not let anecdotal stories rush us toward solutions which may have hidden pitfalls. What I am concerned about is that we go beyond ensuring that disclosure is made and start intervening into legal contracts made between the homebuyer and lender.

There is no doubt PMI is a contract between private corporations and individual homeowners and should be canceled as the contract calls for. Private mortgage insurance companies carry big risks and when there are economic downturns, like in the 1980's, there are a huge number of foreclosures.

I understand the Chairman's reasons for introducing legislation, but I believe it is unfortunate that Government sees the need to step into this debate just as the industry participants seem to be close to resolving this dilemma.

Congress should move carefully into this area and weigh and examine the issues before we rush to impose requirements. I don't know if a broad policy can be applied. I would suspect each individual loan must be taken into consideration.

I have many questions and concerns, and I look forward to the testimony of our distinguished guests.

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## PREPARED STATEMENT OF SENATOR RICHARD H. BRYAN

Mr. Chairman, thank you for holding this hearing on private mortgage insurance and S. 318, the Homeowners Protection Act of 1997. Mortgage insurance is an important issue that every homeowner and potential homeowner needs to be informed about.

Private mortgage insurance (PMI) enables many consumers, who do not have a large enough downpayment, to purchase a home. PMI is required by most lenders whenever a borrower obtains a loan with a downpayment of less than 20 percent. As we know, the insurance protects the lender against default, while the homeowner pays the premium. At the same time, it is expensive and, in many cases I am afraid, the homeowner pays far longer than required.

Most homebuyers would elect not to pay this insurance fee if they had a 20 percent downpayment. But, when a 20 percent downpayment is out of the question—which is very often the case with first-time homebuyers—paying the fee is their only choice. If homeowners knew they had the option to cancel PMI when they have

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accumulated sufficient equity in their homes to protect the lender's investment, I believe most would choose to cancel.

Many homeowners do not realize they have this option. Lenders are not required to disclose this information during the closing process, and most do not. As a result, thousands of Americans continue to pay those insurance premiums well after they need to.

According to a recent newspaper report, a Dallas-based loan portfolio analyst said he believes that as much as one-fifth of some lenders' mortgage portfolios consist of PMI-insured loans with equities that are greater than 20 percent of current market resale value. In addition, the president of a mortgage investment company said in an interview that in a recent analysis of a portfolio, consisting of 20,000 loans, PMI was still being collected on about 4,000 of the loans.

Lack of information is not the only problem. Many homeowners who are aware of the law and who try to cancel their insurance find it a difficult and sometimes frustrating process. In fact, in my home State of Nevada, I have had constituents contact me asking for help in canceling their insurance policy because the lenders have not followed through with their request. In some cases, the lender will try to discourage the homeowner from canceling the policy by requiring an appraisal of the property which must be paid for by the homeowner.

Our bill would change this unfair practice that affects many thousands of homeowners in the country. This legislation would give both current and future homeowners the right to cancel private mortgage insurance once the 20 percent threshold has been reached. The legislation would require written notification to homeowners at closing and at least once a year. I will be interested to hear from the witnesses this morning to learn what your views are on an automatic cancellation of the private mortgage insurance once the 20 percent threshold has been reached. This is another approach that deserves consideration.

Mr. Chairman, I am pleased to be a cosponsor of this important legislation and believe it is a positive and needed step to protect consumers. I urge the Committee to pass it quickly, and let it become law this year. This is not an overly controversial issue and should not hibernate for years before we take corrective action.

Mr. Chairman, this is an important hearing, and I look forward to hearing from our witnesses this morning.

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## PREPARED STATEMENT OF SENATOR MICHAEL B. ENZI

Good morning, Mr. Chairman and witnesses. Thank you for the opportunity to have a hearing on the Homeowners Protection Act of 1997 and for your willingness to cooperate. I want to see every family in America have the ability to own a home. There is pride in ownership. With that pride comes more responsibility. With more responsibility comes a better community and society in which to live because of the consequences to our actions. Legislation that affects an increasing number of homebuyers deserves close and careful attention.

In analyzing all legislation, I take great care to note whether it will create more Federal regulation and oversight. I am strongly in favor of honoring the decision-making ability of our families and communities. The best decisions are those which are made at home. I am also interested in protecting working families from unfair business practices.

Private mortgage insurance has enabled many consumers to achieve the American dream of homeownership. The families that the private mortgage insurance industry ultimately serves could not, without insurance, own a home because of the large initial deposit they have to put down. With private mortgage insurance, more working families are able to own a home with a smaller downpayment. Owning a home is an investment. If a family rents a home, it will never see that money again.

I acknowledge that there may come a time when the protection provided to the lender becomes no longer necessary. We should carefully investigate at exactly what point the homeowner's equity investment will give the lender sufficient assurance against default.

The costs associated with the annual notification requirement will ultimately be passed on to the consumer. I want to find out what the costs associated with that annual notification would be. It is sensible to require notification at closing. Currently, four States have laws pertaining to cancellation of PMI. Does this suggest that this is an overblown, perceived problem? Are we creating feel good legislation, or will it actually produce real results that do not hurt the consumer, creditor, and insurer?

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I look forward to the testimony of all witnesses here today. The statements made today will affect the future of this and any related legislation. I anticipate finding out how S. 318 would affect the insurers, lenders, and families of America.

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## PREPARED STATEMENT OF SENATOR CHRISTOPHER J. DODD

Thank you, Mr. Chairman, for scheduling today's hearing. I want to commend you for acting expeditiously to correct an unfortunate situation in which consumers end up paying mortgage insurance premiums long after the insurance has completed its task.

Let me preface my remarks by first acknowledging the important role that private mortgage insurance plays in making homeownership affordable. PMI allows those consumers who might possess the ability to meet monthly mortgage payments, but who lack the capital to put down the traditional 20 percent, to more easily obtain a mortgage.

PMI provides the lender with protection for the difference between the downpayment and the 20 percent loan-to-value threshold. Theoretically, PMI provides an important service for both consumer and lender. However, as we all too well know, theory does not always translate into practice.

The simple fact is that in many, many instances consumers continue to pay the premiums on their mortgage insurance long after the reason for having that insurance has passed.

I am not generally enthusiastic about Congress jumping in and trying to fix every problem by micromanaging private industry. However, it is apparent to me through the materials I have seen in advance of today's hearing that Congress must act in order to fix this long-festering problem.

Unfortunately, I have little confidence that, absent statutory disclosure language, industry will of its own volition provide homeowners with the necessary tools to end what has been, from an industry perspective, a lucrative gravy train. After all, how many industries can claim to be able to get consumers to pay for something for years and years after the service has been rendered?

I would also like to note, Mr. Chairman, that I am encouraged by the philosophy that underlies the solution to this problem that is embodied in S. 318.

Sometimes, when Congress considers consumer protection legislation, there is a tendency—on both sides of the aisle—to try and draft laws that vainly, in my opinion, seek to protect consumers from themselves by trying to arbitrarily prohibit this or that activity. I don't think our statutes are most successful when they are written from the perspective that somehow we, by virtue of sitting around this dais or even in one of those witness chairs, know better than the "average" American.

I am pleased that S. 318 avoids this pitfall by providing consumers with the tools that they need to make their own informed decisions, and then trusting that the consumer will possess enough self-interest to cancel their own PMI once they know that it is no longer needed.

With that, I look forward to the testimony of today's witnesses and I also look forward to working with you, Mr. Chairman, to close this loophole once and for all.

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## PREPARED STATEMENT OF JAMES V. HANSEN

A U.S. REPRESENTATIVE IN CONGRESS FROM THE STATE OF UTAH

FEBRUARY 25, 1997

### Introduction

Mr. Chairman and Members of the Committee on Banking, Housing, and Urban Affairs, it is a pleasure to be here today. I appreciate the opportunity to discuss private mortgage insurance (PMI). I commend the Chairman for raising the important issue of what homeowners should know when they obtain a home mortgage and, *more importantly*, when they can stop paying for insurance they no longer need.

### Role of the Mortgage Industry

Mr. Chairman, I applaud the changes that have occurred during the last few years regarding the origination of home loans. More people are becoming homeowners and more banks are providing mortgage credit. The market is making homeownership a reality to many people, and I want to commend the mortgage industry for their innovative thinking in developing alternative mortgage instruments that target people who never thought they would be able to afford a home. My office has

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worked closely with the industry for more than a year now, and I believe we are making progress. I applaud the Mortgage Insurance Companies of America (MICA) for identifying the need to get more people into homes, who otherwise would not have been able to afford one without MICA's insurance. Millions of people have become homeowners with the help of private mortgage insurance. Last year, PMI was unknown to many people. With your attention, Mr. Chairman, we will change that today.

My interest in the mortgage industry began when I left college many years ago. One of my first jobs was working with a mortgage company, and then later with an insurance company. During that time I learned that if an industry polices itself, the Government should not interfere. I firmly believe that the Government should stay out of the private market. However, when an industry will not follow its own guidelines—I draw the line. For this reason, I come before your Committee to address a problem that is occurring for homeowners who overpay private mortgage insurance because they either are not told what it is; or what the requirements are to cancel it. Let me illustrate this point with two examples:

In the early 1980's, I bought a condominium in Northern Virginia. I did not want to invest a lot of money here because, as we all know, Congress can end up being a part-time job. As I paid my monthly mortgage to my mortgage servicer, I noticed I was paying around $20 a month for PMI. Being the fiscal conservative that I am, I wanted to find out what it was, and what I could do to stop paying it. When I called the mortgage servicer, I was told that **PMI protects the lender** in case I default on my mortgage. Since I did not put down 20 percent on my home, I was required to pay it. This made sense. I then asked my mortgage servicer what steps needed to be taken to cancel my PMI, and just like for thousands of other homeowners, that's when the real adventure begins.

After a short conversation with my mortgage servicer, I was told that I needed to pay $4,000 to arrive at the loan-to-value (LTV) ratio that the investor required. The LTV ratio was an assurance to the servicer that I was no longer a risky investment, and if I had a LTV of 80 percent, I would no longer need PMI. That sounded reasonable, so I paid the lump sum. However, later that year I realized I was still paying for PMI. Assuming this to be an error, I called my mortgage servicer and told them to fix it. This did not occur. I was told additional requirements needed to be met. At no time did my mortgage servicer indicate everything I needed to do to cancel PMI. Each call to my servicer entailed new steps that needed to be taken to prove that I was not a risky borrower. One month I was told to get an appraisal. The next month I had to prove that I had a good payment history. The month after that I needed to use their appraiser. Each month it was a new requirement.

### Extent of the Problem

After 4 years of negotiating with my mortgage servicing friends in Oklahoma, I decided to investigate how widespread the problem was. Now you may not think that $20 a month is a lot, but when its paid by millions of homeowners we start talking about real money. Now, as any good businessman can tell you, if you can get a little money from a lot of people, you really have something.

After an initial search, I discovered that the problem was more widespread than I had anticipated. There were lawsuits pending around the country, State legislators were drafting legislation to combat the problem, and mortgage companies were settling out of court with promises to cancel thousands of PMI policies that were no longer needed. Furthermore, when I raised the issue in town meetings, people began to tell me their horror stories, and many are worse than mine.

In each case there was one similar problem—homeowners did not completely understand what PMI was and under what circumstances it could be canceled. I have included the actual language from a mortgage servicing company's guidelines to illustrate this point:

> **You are required to maintain PMI over the life** of your loan unless prohibited by applicable law. **We will consider your written request to terminate PMI** during the life of your loan if the additional risk resulting from termination of PMI is acceptable to us and to any investor who then owns your loan. *The acceptability of such risk will be evaluated based upon a number of factors including, but not necessarily limited to,* the age of your loan, your payment record, the length of time since your most recent payment increase (if your loan provides for payment adjustments), whether or not you then reside in the property, the ratio of then unpaid principal balance of your loan to the lesser of the original purchase price or the original appraised value of the property, and whether or not the property may have diminished in value. In certain circumstances, we may require a current appraisal of the property. Under certain limited conditions we will give consideration to the amount of appreciation in the value of the property since the

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date of purchase, you must pay the cost of any appraisal and any permitted fee we then impose for evaluating your request. **However, we are under no obligation to terminate PMI** prior to the termination of your loan **unless required by applicable law**. [emphasis added]

After reading this, I am sure you can see how any homeowner could be confused about private mortgage insurance. No industry guidelines oversee it. The confusion abounds. You can only play with words so long before they mean nothing and do even less.

**Mortgage Servicing Disclosure Examples**

*Georgia Example*

To clearly illustrate this point, I submit the following account of a woman who lives in Georgia and have included a two-page letter she received from her mortgage servicer for the record. In her letter to me she states:

> In 1983, I purchased a single home in Georgia for $50,718 on a variable-rate mortgage arranged by the seller's realtor. The mortgage was owned by a company who then sold the servicing arrangement to a bank on the east coast.
>
> From the start of my loan and for the next 12½ years, I was charged and paid $238.44 a year for PMI. The cost of the insurance did not vary over that time, although the principal owed decreased from $50,718 to less than $3,000 in January 1996.
>
> In late 1995, I began to inquire of my mortgage servicer about the necessity of the insurance after seeing by chance a short conversation about PMI on the Internet. The company at first refused to cancel the insurance because they incorrectly identified my loan as an FHA loan. I continued to pursue the issue with my mortgage servicer, explaining that I had a conventional loan, and as soon as they admitted their error, the PMI insurance on my mortgage was terminated at my request and became effective in 1996.
>
> At the time of the termination, I asked for clarification about PMI from my mortgage servicer and they informed me that in the event that I had no delinquent payments in my history, 'PMI could have been waived at a principal balance of $42,800,' (letter enclosed). The balance on my mortgage equaled the $42,800 value at the end of 1988, or 7 years before I had any idea that PMI could be canceled.

For 7 years this woman unknowingly and in my opinion needlessly overpaid her mortgage servicer more than $4,000, and not once was she told that she did not have to keep paying it. There is some good news now. For example, at Navy Federal Credit Union, PMI is automatically canceled at 80 percent LTV. This is both good for the consumer and, I submit, good business. I look forward to hearing from them later this morning about how we can stop the abuse of PMI.

**Conclusion**

The bottom line is that thousands of hard-working American homeowners overpay PMI each year because they don't know what it is or how to get rid of it. **There is nothing more frustrating then paying for something that is not needed.** Mr. Chairman, we must act. **With PMI, the people who can afford it least end up paying the most and we should stop it today.**

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Jan 3 '96 PMI
Removed
at my
request

January 24, 1996

Augusta, GA.

Re: Mortgage No.

Dear

Thank you for your recent inquiry regarding your private mortgage insurance. The following information is provided for your records.

The private mortgage insurance is a mandatory requirement under the terms of this conventional mortgage. The private mortgage insurance protects the holder of the mortgage in the event of default or foreclosure. This insurance does not protect you or your home in any way.

We consider waiver of the private mortgage insurance after the following requirements have been met:

> There must have been no payments received late within 12 months of your request.
>
> The principal balance must be reduced to less than 80% of the original appraised property value or a new appraisal must be submitted indicating that, due to property appreciation, the principal balance has been reduced to less than 80% of the current appraised property value. This new appraisal must be submitted on the appropriate FNMA/FHLMC form.

Based on your original appraisal of $53,500.00, the private mortgage insurance could have been waived at a principal balance of $42,800.00. At that point your loan to value ratio would have been 80%. We are not required to notify you that the criteria has been met. Upon request, your account is reviewed for possible waiver.

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Mortgage No.
page 2

We do not provide you with the name or telephone number of your private mortgage insurance company as they do not have the facilities to handle customer service issues.

We act as a liaison for questions or concerns that you may have regarding discrepancies or changes in your premiums. We have no financial interest in any of the private mortgage insurance companies and we do not keep any portion of your premium.

Enclosed please find a loan history for your records. Should you require additional assistance, please contact our Customer Service Department at 1-800-

Sincerely,

Senior Account Specialist
Customer Service Department

/jt

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ublisher of Consumer Reports

**Testimony of**
**Michelle Meier**
**Counsel for Government Affairs**
**Consumers Union**

**on**
**S. 318: A Bill To Make Home Mortgages**
**Fairer and More Affordable**

**before the**
**Senate Committee on Banking, Housing, and Urban Affairs**

**on**
**Tuesday, February 25, 1997**

Washington Office
1666 Connecticut Avenue, Suite 310 • Washington, D.C. 20009-1039 • (202) 462-6262

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Consumers Union[1] appreciates the opportunity to appear today in strong support of S. 318, a consumer protection bill recently introduced by the Chairman of this Committee, Senator Alfonse M. D'Amato. Chairman D'Amato's consumer protection proposal will help make the mortgage market fairer and homeownership more affordable by prohibiting lenders from requiring borrowers to carry private mortgage insurance (PMI) when it is no longer necessary. This consumer protection reform is a critical component of a package of reforms that are critically needed to make the mortgage market fairer and more affordable for consumers.

**S. 318 Will Stop Mortgage Lenders from Using One of Several Unconscionable Practices that Unfairly Burden American Families**

In discussing this legislation with my colleagues, I have found many are incredulous to learn that some mortgage lenders require PMI even when the borrower's ratio of loan balance to home value ("loan-to-value" ratio or "LTV") is 80 percent or less. Why should consumers pay a premium each month to protect their mortgage lender against default when the risk of default is virtually non-existent?

First, borrowers are extremely unlikely to walk away from their mortgage loan after building a 20 percent ownership stake in their homes. Second, if borrowers with a 20 percent or greater equity stake run into unexpected financial problems, they can sell their home and generate proceeds that will be more than enough to repay the outstanding mortgage debt.

If mortgage lenders have no legitimate interest in requiring PMI when their borrowers have a 20 percent or greater equity stake in their home, why do borrowers continue to pay a PMI premium even after they have reached or exceeded this 20 percent threshold? According to an estimate cited in a February 22 *Washington Post* story by the nationally syndicated real estate columnist Ken Harney, borrowers on 4,000 loans in a 20,000 loan portfolio were still paying PMI despite having an equity interest in the property of 20 percent or more.[2]

We believe there are two primary reasons that consumers are being forced to fork up these unnecessary premium payments:

- *Borrowers With a Right to Cancel PMI Are Not Told of Their Right.* Some borrowers, it seems, currently have a right to discontinue their PMI payments and coverage. For example, Fannie Mae guidelines state that borrowers who jump threugh certain hoops may cancel their PMI when their loan-to-value (LTV) ratio reaches 80 percent. However, many if not most consumers who could benefit from this rule are unaware of it. Additionally, this right has several conditions attached to it and only applies if the borrower's loan has been purchased by Fannie Mae.

  To the extent borrowers have a right to stop making PMI payments but do not know it, a simple requirement that lenders (or servicers) notify their borrowers when the 80 percent threshold is reached would be helpful.

  *A far more effective and fair approach, however, would be to simply prohibit lenders and servicers from charging consumers for PMI once this threshold has been reached.* After all, most consumers only make the unnecessary payment because they are told to do so, in one way or another, by their mortgage lender or servicer. This is unconscionable. Lenders and servicers should not be allowed to "bill" for services that are no longer necessary.
- *Borrowers Have No Right to Cancel Because Their Mortgage Agreement Requires PMI Through the Life of the Loan.* Over the years, we have periodically heard of brave and savvy consumers who fight losing battles with their mortgage lenders to terminate their regular PMI payments when they have built up so much equity in their home that PMI is no longer necessary. These consumers know that PMI is no longer necessary from a financial risk standpoint, but they learn, to their extreme frustration, that it is required by the contract their lender wrote. We believe that contract clauses requiring PMI through the life of the mortgage loan may be widespread among mortgage lenders.

[1] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education, and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of *Consumer Reports*, its other publications, and from noncommercial contributions, grants, and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* with approximately 5 million paid circulation, regularly carries articles on health, product safety, marketplace economics, and legislative, judicial, and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

[2] According to the Harney piece, these numbers came from Lewis Hill, President of First American Tax Valuation Co., a Dallas-based firm.

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*This unfair practice among mortgage lenders can only be solved by prohibiting mortgage lenders from requiring PMI once the need for PMI is eliminated, which is the approach taken by Chairman D'Amato's bill.* Consumer notification is important so that consumers are aware of their rights. However, a law notifying consumers that PMI may no longer be necessary will not help protect consumers if PMI is required as a matter of contract. These unfair contract terms must be made unenforceable as a matter of law.

Given the mortgage lending industry's sorry history in this area, we believe it is not enough to simply prohibit lenders from requiring PMI once the 80 percent threshold has been reached. We encourage adding a provision to S. 318 that would penalize lenders that charge or attempt to collect PMI once the statutory threshold is met.

**Other Consumer Protections Are Urgently Needed to Make the Mortgage Process Fairer for Consumers**

The PMI problem is just the tip of the iceberg. Consumers face an array of hidden land mines as they try to protect their families' economic security when financing or refinancing their home. Unnecessary PMI expenses are one trap that can strap a family's budget. An unnecessarily high note rate, which can add thousands of dollars to a family's housing expenses each year, and other expenses incurred as part of the financing or refinancing package, can destroy a family's financial well-being.

Consumers face these problems because of loopholes in the Truth-in-Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA). For example:

- *Under TILA, basic disclosures about the key terms of the mortgage loan are generally not required until AFTER the consumer has already submitted a loan application and hundreds of dollars in fees.* Except in limited circumstances, TILA only requires lenders to make a basic disclosure of key loan terms *within three days* after the consumer submits a loan application. Obviously, TILA should always require lenders to provide basic information about the loan terms they are offering *BEFORE* the consumer is forced to apply and incur the hefty expenses normally associated with applying.
- *Under TILA, the note rate and points charged by the lender are not a part of the TILA disclosure eventually received.* Since consumers shop heavily on the basis of these terms, TILA should be amended to require lenders to disclose these essential terms.
- *Under TILA, the terms disclosed shortly after the application is submitted can change at the closing.* All the lender needs to do is to make a subsequent disclosure in the closing room. This virtually unlimited right of the lender goes far beyond prudent flexibility. It produces a one-sided transaction with the lender in the driver's seat.

  TILA should be amended to require lenders to stick with the terms they disclose up-front, at the time the consumer decides to submit an application. Unless the lenders are forced to honor their disclosures, the disclosures are meaningless.

These are some of the more obvious loopholes in the laws under which consumers are forced to make one of the most important financial transactions of their lives. We look forward to working with you, Senator D'Amato, and all the distinguished Members of this Committee to give American families the tools they desperately need to protect their financial health when financing and refinancing their homes.

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## PREPARED STATEMENT OF R. LAYNE MORRILL

1997 PRESIDENT-ELECT, NATIONAL ASSOCIATION OF REALTORS®

FEBRUARY 25, 1997

Chairman D'Amato and Members of the Committee, I am Layne Morrill, the 1997 President-elect of the National Association of REALTORS®. I am also President of Shepherd of the Hills REALTORS® in Kimberling City and Branson, Missouri, and a certified real estate broker.

On behalf of REALTORS®, I am pleased to present our views concerning S. 318, the "Homeowners Protection Act of 1997." We commend you, Mr. Chairman, for introducing this proposed legislation to protect homeowners from paying unnecessary private mortgage insurance (PMI). This is an important consumer issue that deserves to be addressed forthrightly.

At the outset, Mr. Chairman, let me make clear that REALTORS® believes that private mortgage insurance clearly serves a useful purpose. More than half of all homebuyers who make downpayments of less than 20 percent carry private mort-

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gage insurance, while the remainder of the market is served by Government housing finance programs. PMI protects lenders against loan defaults and helps to make mortgage financing more accessible to homebuyers with smaller downpayments. Generally, private mortgage insurance is required for loans covering more than 80 percent of the home value. However, once a homeowner exceeds 20 percent of equity in a home, we believe that PMI is no longer needed. There is no benefit to the homeowner from these extra mortgage insurance payments.

### REALTORS® Position

The National Association of REALTORS® strongly supports the intent of S. 318. REALTORS® policy supports the disclosure of the mortgage insurance carrier at settlement and subsequent written notification to the borrower regarding the right to and conditions for PMI cancellation.

Although S. 318 does not explicitly call for it, REALTORS® believes that the private mortgage insurer should be disclosed to the homebuyer at settlement, despite the fact that a mortgage insurer's client is the lender, not the homebuyer. Homebuyers pay the mortgage insurance premium. The private mortgage insurance carrier's identity is very important information for the homeowner to know up front and the disclosure of this information, while it may not be immediately relevant to the homeowner, takes on immediacy and relevance with the transfer of mortgage servicing, when a homeowner may encounter difficulties affecting repayment of the mortgage loan, or be subject to other situations over time that can make this single bit of information critical in negotiations with a mortgage lender.

### Unnecessary Costs

It is estimated that millions of American homeowners are paying for unneeded private mortgage insurance. The proposed legislation should help to stop this unnecessary drain on homeowners' pocketbooks. We support the objectives of Senator D'Amato's and Representative Jim Hansen's bills in their effort to save homeowners nationwide hundreds of millions of dollars a year by empowering them with the right to cancel their private mortgage insurance when it is no longer needed.

At the very least, homeowners should be notified when they have paid off 20 percent of their mortgage loan. They deserve the right to stop making these insurance payments at that point. Homebuyers and homeowners have plenty of legitimate expenses without being saddled with costs that give them no benefit.

### Increased Loan Servicing Costs

We anticipate that S. 318 could engender concerns about additional loan servicing costs associated with annual written notification and tracking the buildup of homeowner equity. While we do not dismiss these potential concerns out of hand, we believe that competent loan servicers should already have in place technical and human resources to respond to this challenge. Mortgage principal balances, escrow accounting, real estate tax disclosures, are all part of a year-end statement that lenders make to their customers for Federal income tax reporting purposes through the Form 1099 and escrow analysis required by Federal statutes. It is difficult for us to imagine that lenders are not adaptive enough to positively respond to the disclosure requirements of S. 318. Further, it is appropriate that mortgage insurers should reimburse loan servicers, as proposed in Section 126(e) of the bill, for any costs associated with notifying homeowners.

### Benefits of Disclosure

We believe that there is a win/win opportunity provided in Senator D'Amato's proposal. Looked at solely from a customer relations viewpoint, mortgage lenders can make a giant step forward in shoring up their relationships with homebuyers. For the real estate agent, disclosure of private mortgage insurance is an important piece of information that every homeowner should know.

For REALTORS®, disclosure of any pertinent information affecting the terms of a mortgage loan, conditions of homeownership and repayment of the mortgage obligation to the consumer, is a key principle that we use daily. We believe that well-informed homesellers and homebuyers, who are fully cognizant of their obligations and rights, should be critical to any mortgage finance transaction. The relationship that develops between a REALTOR®, a homebuyer, and a homeseller, is oftentimes unique. The most successful are those that result in repeat clients. We think that this is a principle central to any business that relies on customer service, as well as consumer satisfaction.

### Short Payoff Sales

An example of how PMI disclosure can benefit mortgage insurers, lenders, and homeowners is the situation involving short payoff sales. Since regional economic

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conditions in some real estate markets can cause declines in property values, the occurrence of short payoff property sales may become necessary to facilitate real estate sales. Short payoff sales occur when lenders agree to the sale of a property for a price below the amount needed to fully pay the outstanding mortgage. Short payoff sales typically occur when homeowners experience financial difficulties and need to sell their home, but their property value declines below the amount of the original mortgage. Lenders often accept the short payoff in an effort to avoid the expense and potential problems associated with foreclosure.

REALTORS® experience difficulties in some markets when attempting to assist homesellers or homebuyers to negotiate with lenders in short payoff situations. In these instances, the private mortgage insurer can be the consumer's ally because it is in the private mortgage insurer's best interest, as well as the lender's, to avoid foreclosure. S. 318 could facilitate this process for REALTORS® and their clients through the disclosure of the loan servicer, who when contacted directly to negotiate, could benefit from short payoff sales.

**Other Issues**

The failure of some lenders to facilitate private mortgage insurance cancellation gained some outraged responses through national television exposure as an example of "The Fleecing of America," to use one network's tag line. Syndicated columnist Ken Harney also called attention to the situation recently in at least two instances, and it was one of Mr. Harney's columns that called attention to anticipated policy changes at Fannie Mae affecting the cancellation of PMI. S. 318 is clearly a step in the right direction to assure that homeowners are aware of their rights to cancel PMI.

As deliberations proceed on PMI cancellation and notification proposals, some critics may argue that S. 318 goes too far in requiring notification to all homeowners of their mortgage insurance cancellation rights. We believe that universal notification is appropriate because, whether unintentional or not, lenders who retain unnecessary mortgage insurance premiums are doing the mortgage finance industry a disservice in the long run. Retaining or maintaining PMI beyond its usefulness to the homebuyer is a practice that for the good of all those associated with the home mortgage industry should be ended.

**Original Value vs. Appraised Value**

S. 318 proposes automatic cancellation of PMI once the equity threshold on the original mortgage value is reached. There are clearly arguments that can be made for either using the original value or an appraised value where PMI cancellation is concerned. We point out, however, that when the homeowner takes the initiative to exercise PMI cancellation rights reaching agreement on an acceptable appraised value with a lender, tremendous frustration often follows for the homeowner. It is in these instances when homeowners are oftentimes thwarted by reticent lenders, who seek to continue receiving PMI premiums or to delay cancellation.

PMI cancellation should be easier for the consumer. Demands for redundant appraisals, which result in additional costs to the consumer, should not be permitted. Any appraisal by a licensed or certified appraiser should be honored by the lender, and the PMI process should not be thwarted or delayed resulting from failure to reach agreement on appraised value or mortgage principal balance.

The following unsolicited personal experience illustrates what many homeowners oftentimes encounter.

On Tuesday, February 18, Michelle Meeks, a Michigan resident in the market for a new home, called the National Association of REALTORS® in response to a press release posted on NAR's home page which praised Senator D'Amato and Representative Hansen for introducing their PMI bills. Mrs. Meeks volunteered that she is having a very difficult time canceling her PMI, and she hopes that Congress passes S. 318. This is her story:

Early in 1996, Mrs. Meeks contacted her mortgage lender and requested that her PMI be canceled. She was told she would have to obtain an appraisal of her home and the cancellation fee would be $250. When she questioned the $250 fee, the lender advised that both the appraisal and the fee were stipulated in her mortgage. Mrs. Meeks searched through her mortgage papers and found no such reference to either the fee or the appraisal, however she did not pursue the PMI cancellation further.

In February of this year, Mrs. Meeks resumed her pursuit of the PMI cancellation. Her mortgage had been sold to a different mortgage company. The new lender advised that canceling the PMI would require an appraisal no more than 6 months old and a cancellation fee of $50.

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Because Mrs. Meeks had obtained a home equity loan in May of 1996, she had already paid $200 for an appraisal that was only 9 months old. When pressed about the appraisal, the lender responded the appraisal must be no more than 6 months old because it is based on the "updates to your home." The lender also stated that they "choose" to let the homeowner cancel the PMI, and they are not legally bound to inform the homeowner that the PMI can be canceled. In order for Mrs. Meeks to cancel her PMI, she will have to pay for another appraisal plus the $50 cancellation fee. Her out-of-pocket cost will be at least $450.

Mrs. Meeks says, "I know there are thousands more out there who either aren't aware that their PMI can be canceled or are in the same situation as I am. Financial institutions are making major bucks off this."

**Conclusion**

Mr. Chairman, private mortgage insurance is a very important component in the American system of mortgage finance. This system, driven largely by the maturing secondary mortgage market, new technologies, and growing sophistication on the part of all parties in the mortgage lending process, continues to evolve. Six States—California, Connecticut, Hawaii, Maryland, Minnesota, and New York—now require the cancellation of private mortgage insurance once a prescribed equity threshold is reached. The New Mexico State legislature is considering similar legislation this year. Indeed, Fannie Mae and Freddie Mac have guidelines for those lenders from whom they purchase loans that support the cancellation of private mortgage insurance. But a surprising number of homeowners are unaware of their rights and conditions under which they may cancel private mortgage insurance. The net result is homeowners' excessive payment of PMI premiums, in an alarming number of instances, once the equity threshold is attained on their mortgage. This is a situation that should end.

Again, we commend Senator D'Amato for raising the public's and policymakers' awareness of this important issue and in giving momentum to the process of lifting this unfair burden on America's homeowners.

This concludes my testimony, Mr. Chairman. I will be pleased to respond to any questions there may be.

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# Mortgage Amortization Table

**$100,000 Mortgage 7.5 % Interest Rate 30-Year Fixed Rate Monthly Payment $699.21**
**Mortgage Insurance Premium 1.1% Upfront, 0.49% Annual Renewal**
**Mortgage Insurance Coverage 25 %**
**Sales Price = $105, 263**

| Year | Annual Interest | Annual Principal | Outstanding Principal Balance (OPB) | Annual Mortgage Insurance | OPB / Original Mortgage Amount |
|---|---|---|---|---|---|
| 1 | $7,468.74 | $921.83 | $99,078.17 | $485.48 | 99.08 % |
| 2 | $7,397.18 | $993.40 | $98,084.77 | $480.61 | 98.08 |
| 3 | $7,320.06 | $1,070.52 | $97,014.25 | $475.37 | 97.01 |
| 4 | $7,236.95 | $1,153.63 | $95,860.62 | $469.72 | 95.86 |
| 5 | $7,147.39 | $1,243.19 | $94,617.44 | $463.63 | 94.62 |
| 6 | $7,050.88 | $1,339.70 | $93,277.74 | $457.06 | 93.28 |
| 7 | $6,946.87 | $1,443.70 | $91,834.04 | $449.99 | 91.83 |
| 8 | $6,834.79 | $1,555.78 | $90,278.26 | $442.36 | 90.28 |
| 9 | $6,714.02 | $1,676.56 | $88,601.70 | $434.15 | 88.6 |
| 10 | $6,583.86 | $1,806.71 | $86,794.99 | $425.30 | 86.79 |
| 11 | $6,443.60 | $1,946.97 | $84,848.01 | $415.76 | 84.85 |
| 12 | $6,292.45 | $2,098.12 | $82,749.89 | $405.47 | 82.75 |
| 13 | $6,129.57 | $2,261.01 | $80,488.89 | $394.40 | 80.49 |
| 14 | $5,954.04 | $2,436.53 | $78,052.35 | $382.46 * | 78.05 |
| 15 | $5,764.89 | $2,625.69 | $75,426.67 | $369.59 * | 75.43 |
| 16 | $5,561.05 | $2,829.53 | $72,597.14 | $355.73 * | 72.6 |
| 17 | $5,341.38 | $3,049.19 | $69,547.95 | $340.78 * | 69.55 |
| 18 | $5,104.67 | $3,285.91 | $66,262.04 | $324.68 * | 66.26 |
| 19 | $4,849.57 | $3,541.00 | $62,721.04 | $307.33 * | 62.72 |
| 20 | $4,574.68 | $3,815.90 | $58,905.15 | $288.64 * | 58.91 |
| 21 | $4,278.44 | $4,112.13 | $54,793.01 | $268.49 * | 54.79 |
| 22 | $3,959.20 | $4,431.37 | $50,361.64 | $246.77 * | 50.36 |
| 23 | $3,615.18 | $4,775.39 | $45,586.25 | $223.37 * | 45.59 |
| 24 | $3,244.46 | $5,146.12 | $40,440.14 | $198.16 * | 40.44 |
| 25 | $2,844.95 | $5,545.62 | $34,894.52 | $170.98 * | 34.89 |
| 26 | $2,414.43 | $5,976.14 | $28,918.37 | $141.70 * | 28.92 |
| 27 | $1,950.49 | $6,440.09 | $22,478.29 | $110.14 * | 22.48 |
| 28 | $1,450.49 | $6,940.05 | $15,538.24 | $76.14 * | 15.54 |
| 29 | $911.75 | $7,478.82 | $8,059.42 | $39.49 * | 8.06 |
| 30 | $331.15 | $8,059.42 | $0.00 | $0.00 * | 0 |

* Presumes that MI is canceled when outstanding principal balance/original mortgage amount = 80 %. Lender policy may vary; cancellation dependent on contract between lender and insurer.

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## PREPARED STATEMENT OF KENNETH L. NICHOLSON, SRA

PRESIDENT, NICHOLSON & COMPANY
1997 PRESIDENT OF THE APPRAISAL INSTITUTE
ON BEHALF OF THE
APPRAISAL INSTITUTE

FEBRUARY 25, 1997

Mr. Chairman and Members of the Committee, my name is Kenneth L. Nicholson and I am the 1997 President of the Appraisal Institute. I am a designated member of that organization and have earned the Senior Residential Appraiser designation. I commend you for calling this hearing and thank you for the opportunity to testify on S. 318, the "Homeowners Protection Act of 1997."

I am a practicing real estate appraiser specializing in residential properties in Overland Park, Kansas, where I got my start in business with Capital Federal Savings and Loan more than 30 years ago. I have direct experience in the delivery of appraisals for private mortgage insurance cancellation purposes. I am proud to represent the Appraisal Institute, which is the Nation's largest professional association of residential and commercial real estate appraisers. Our membership of 24,000 is proud of our 65 year heritage and commitment to advancing the professionalism of real estate appraisers. This commitment is demonstrated by our delivery of both primary and advanced education on appraisal related matters. We are the largest publisher of real estate appraisal literature in the world. I am especially pleased to be here because of our pro-consumer mission, which is to deliver objective information about the value of a person's home and other investments in real estate.

### Automatic Cancellation

Mr. Chairman, as I understand it, your legislation calls for the cancellation of private mortgage insurance, or PMI, when a borrower's equity in real estate securing a residential mortgage equals a predetermined ratio. That ratio, in my area of the country, is generally 80 percent of the appraised value. We believe that at the time of closing, the consumer should be informed of the conditions for cancellation of PMI. Presumably, an amortization schedule based on the terms of the initial transaction could indicate a future termination date. Such an approach would rely heavily on the appraisal of the property performed for the original mortgage transaction. With an automatic cancellation based upon the original value of the property, the reliability of the initial estimate of value is critical for the borrower, the lender, and the insurer.

### Reliability of Appraisals

While real estate appraisal is not an exact science, appraisers do employ a scientific method. Valuation estimates are based upon a professional analysis of both physical and economic facts. Traditionally, the Appraisal Institute has always been the leader in the development of the standards of practice for the industry. In 1987, we were part of an industry-wide initiative to codify appraisal standards and this initiative resulted in the creation of the Appraisal Foundation and the issuance of national standards known as the Uniform Standards of Professional Appraisal Practice (USPAP).

To ensure the highest degree of reliability for a value estimation, an appraisal should be performed by a qualified and competent appraiser acting in accordance with USPAP. These are an industry accepted set of standards, that help guide the appraiser with a methodology which results in a reliable estimate of value. The Appraisal Foundation, authorized by Congress, is the source of appraisal standards and qualifications in federally related transactions. For our part, the Appraisal Institute, confers meaningful "designations" or credentials, which reflect demonstrated competency and integrity. A competent professional appraiser estimating a property's value in accordance with the industry standards, will set a reliable benchmark benefiting all parties in the mortgage transaction.

### Optional Cancellation

Mr. Chairman, your legislation also addresses notification of the required procedures a consumer would need to take to cancel the PMI at a time prior to an automatic cancellation. Unlike automatic cancellation that relies on an original value and possibly an amortization schedule, cancellation at other points in the loan may or may not consider additional underwriting requirements. If, for example, within the first few years of a loan, a homeowner is in an appreciating market and has made several home improvements, what are the options? The homeowner may believe the property to have surpassed the lender's equity requirements for PMI and

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request that it be dropped. Fairness would dictate that any homeowner should be allowed to cancel coverage that is superfluous. It would also seem reasonable that such a scenario would be foreseeable and disclosed initially. The relevant underwriting considerations for a determination to allow an "early out" would be a matter for the parties to decide.

Factors such as credit history, market conditions, and collateral evaluation are all part of sound decisionmaking in a mortgage transaction. Appraisers are called upon to deliver a wide variety of services to meet the needs of homeowners, lenders, and insurers in today's marketplace. Appraisers are responding to new market demands for services with expanded and new technologies. Enhanced appraisal tools, databases, and other valid methodologies are being utilized by appraisers to deliver quality valuation products to consumers and other clients. We intend to continue to provide these needed services. To the extent that our professional community is called upon to help solve the issues involved in PMI notice and cancellation, we are ready.

**Summary**

Mr. Chairman, the Appraisal Institute's first priority is to protect the public by providing objective information about the value of homes and investments in real estate. Appraisals performed in accordance with USPAP by a competent appraiser provide a reliable estimate of value on which to base PMI requirements. Today, members of the Appraisal Institute are prepared to deliver timely and reliable appraisal services to assist the homeowner, lender, and the insurer in making sound decisions regarding mortgage insurance.

Mr. Chairman, the Appraisal Institute applauds your efforts and looks forward to working with you and the Committee as this legislation moves forward. Thank you for the opportunity to address the Committee. I would be pleased to answer any questions you may have.

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## PREPARED STATEMENT OF WILLIAM H. LACY

CHAIRMAN AND CHIEF EXECUTIVE OFFICER
MORTGAGE GUARANTY INSURANCE CORPORATION

ON BEHALF OF

MORTGAGE INSURANCE COMPANIES OF AMERICA

FEBRUARY 25, 1997

Good morning. My name is Bill Lacy. I am Chairman and Chief Executive Officer of Mortgage Guaranty Insurance Corporation. I am here today representing the Mortgage Insurance Companies of America.

Thank you for the opportunity to talk about private mortgage insurance and how it helps people buy a home. My industry fully supports your efforts to make it easier to understand the mortgage insurance cancellation process. By working together, I'm confident we can advance helpful legislation on this subject, which is confusing for some consumers.

First, I'll explain what private mortgage insurance is and how it works.

Mortgage insurance protects lenders from loss if a borrower does not make his mortgage payments. For good reason, lenders generally will not make a loan with less than a 20 percent downpayment unless they have mortgage insurance protection. We insure the top 20 to 30 percent on loans with as little as a 3 to 5 percent downpayment. There are eight companies in our industry and last year we insured mortgage loans totaling $127 billion.

Lenders obtain mortgage insurance under the terms of a master policy agreement with mortgage insurers they want to use. Lenders receive no rebate or commission from the sale of mortgage insurance, so they have no incentive to maintain coverage longer than it is needed. In fact, they are precluded by the Real Estate Settlement Protection Act from receiving any referral fees. This is a very important principle that we need to preserve.

While the lender or servicer of the loan communicates with the borrower, the mortgage insurer has no contact with the borrower. Our relationship is with the lender or loan servicer. In spite of that, mortgage insurers share a common interest with the borrower. We want to be sure that the home the consumer buys is one he can afford now and for years to come. Why? Because if the borrower doesn't pay, we pay! Today the homeownership rate in America is almost 66 percent. My industry is proud to play a key role in that accomplishment.



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When we discuss cancellation of mortgage insurance, it's important to note that the decision lies solely with the lender or secondary mortgage market investor who is the beneficiary of our insurance. Once we insure a loan, we cannot cancel it without instructions from the owner of the loan to do so. That is a critical feature of mortgage insurance and without it, the secondary mortgage market would suffer significant adverse effects.

Equally important, mortgage insurers cannot deny cancellation. Decisions to require mortgage insurance and to cancel it are solely at the discretion of the lender or the secondary market investor. That's the way it should be. Otherwise, we might disrupt the flow of funds available for affordable low downpayment mortgages.

For most first-time homebuyers, the greatest single barrier to homeownership is the downpayment. With mortgage insurance, buyers can purchase a home with a very small downpayment, enabling them to become homeowners many years sooner.

Personally, I bought my first home back in 1972 with a 90 percent, MGIC-insured mortgage. Without private mortgage insurance, my family wouldn't have been able to purchase that home. Four years later, we bought a larger home with the appreciation from our first purchase. If we had had to spend 2 or 3 years saving a larger downpayment for that first house purchase, we might have missed the opportunity to be homeowners because house prices were rising faster than my income. I personally am very thankful for mortgage insurance.

Since 1994, private mortgage insurance has now saved homebuyers $38 billion on downpayments. Over the past 40 years, private mortgage insurance has made it possible for 17 million American households to become homeowners as I did in 1972.

Senators, my business is risky. Losses come in large blocks during difficult economic times and they are concentrated regionally even in good economic times. For example, when economic conditions deteriorated in the energy States in the mid-1980's, numerous foreclosures resulted. At that time, my industry paid more than $5 billion on foreclosed mortgages. During this crisis—and in more recent regional downturns in Boston and Southern California—my industry provided the first layer of protection for secondary market investors and for federally-insured lenders. Last year, my industry reported incurred losses of $1.2 billion.

Private mortgage insurance has been embraced by the marketplace as an efficient alternative to FHA insurance. Most importantly, it's a better deal for consumers. For example, while private mortgage insurance is cancelable, FHA insurance is not. A buyer of an $80,000 house with an FHA-insured loan will pay nearly $13,000 in insurance premiums over the term of a 30-year mortgage.

My industry strongly supports full disclosure of cancellation rights to homebuyers. Senator, we are committed to working with you in order to help consumers better understand the mortgage insurance process and their cancellation rights.

We have already demonstrated our commitment by our support of Congressman Hansen's proposal to notify borrowers annually of their right to cancel. We want a simple, commonsense approach to enhancing borrowers' understanding of mortgage insurance.

My industry believes in the following:

- First, at the time of loan origination we want the borrower to know that his loan includes mortgage insurance and how it may be canceled in the future. An explanation of how mortgage insurance works and how it can be canceled is critical to avoid confusion and misunderstandings.
- Second, we support annual notification to borrowers that they can request cancellation of mortgage insurance. This information could be added to the lender's annual year-end statement to the borrower. Done this way, cost would be minimized and mortgage servicers would enhance their relationship with borrowers.
- Third, we support legislation that provides a framework for informing consumers of their opportunities to have their mortgage insurance canceled. At the same time, we need to avoid fixed or hard and fast rules. They do not work in a rapidly changing marketplace.
- Last, as legislation is developed, we must not add unnecessary costs. We enjoy the most efficient mortgage market in the world. It is the envy of the world. Let's work together to keep it that way.

Mr. Chairman, my industry looks forward to working with you on this matter and others affecting homeownership in America. Thank you for inviting me here today.

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Mortgage Bankers
Association of America

Tel: (202) 861-6500
1125 15th Street, N.W
Washington, D.C. 20005-2766

The National Association
of Real Estate Finance

MBA

**Statement of Ron McCord, CMB**
**President**

**American Mortgage and Investment Company**
**Oklahoma City, Oklahoma**

**on behalf of the**

**MORTGAGE BANKERS ASSOCIATION OF AMERICA**

**before the**

**Committee on Banking, Housing and Urban Affairs**

**Hearing on**
**S 318, the "Homeowners Protection Act of 1997"**

**February 25, 1997**

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Mr. Chairman and Members of the Committee, I am Ron McCord, CMB, President of American Mortgage and Investment Company, headquartered in Oklahoma City, Oklahoma. I am currently also serving as President of the Mortgage Bankers Association of America (MBA).[1] With me today are Mike Ferrell, Senior Staff Vice President and Legislative Counsel, Karen Kapen, Associate Director and Counsel, and Shelia Green, Senior Director, Loan Administration.

MBA appreciates the opportunity to appear before the Committee today and to comment on the issue of private mortgage insurance and, specifically, on S. 318, the "Homeowners Protection Act of 1997." We commend you, Mr. Chairman, for holding these hearings and for your continued leadership in this area. We are committed to continuing to work with you and the Committee to seek ways to keep the costs of homeownership at reasonable and affordable levels for the country's homebuyers.

Mr. Chairman, MBA supports the underlying objectives of your bill: to provide clear and concise information to homebuyers relative to their obligation to maintain or the ability to cancel private mortgage insurance (PMI). We do, however, believe it is important to this discussion to provide a fuller explanation of the nature and purpose of PMI and to comment specifically on certain provisions of the legislation that may create unintended operational or administrative problems that could undermine your objectives; impose unnecessary costs and burdens on mortgage lenders and servicers, insurers, and investors; and, thereby, diminish any benefits which could accrue to borrowers.

## Background

Mr. Chairman, private mortgage insurance is designed to spread the potential risk of financial loss that results from mortgage foreclosure over a large population. Specifically, PMI is written by a private company to protect the mortgage lenders against financial loss occasioned by borrowers defaulting on mortgages. In most instances, PMI premiums are paid by borrowers in conjunction with their monthly mortgage payments. These premiums are based on a percentage of the loan amount, and the insurance only covers a specific percentage of the loss.

Today, 13 percent of all of those borrowers who have mortgages are insured by PMI. One out of every seven new loans made each year carries PMI. Although these numbers appear small, they represent a significant additional number of Americans who are able to obtain mortgages due to the availability of PMI. Thus, PMI serves a valuable and practical purpose. It enables more consumers to obtain homes more quickly than they could without PMI.

Overall, PMI is necessary to help more Americans obtain the dream of homeownership. As has been demonstrated through the years, accumulation of the downpayment is one of the single largest impediments to owning a home. The mortgage industry has recognized this problem and has created a vehicle, PMI, to enable borrowers to obtain mortgages in the absence of large downpayments. Typically, PMI is required when a downpayment is less than 20 percent of the purchase price. If one believes in promoting the dream of homeownership for all Americans, then the existence of PMI, in addition to other forms of insurance, such as the Federal Housing Administration insurance programs (FHA), is a virtual necessity.

## Participants in the Mortgage Process

### *The Mortgage Lender*

There are numerous players in the mortgage process. Mortgage bankers currently originate over 50 percent of all new loans. However, in most cases, they are not portfolio lenders and, thus, do not hold the loans they originate. Instead, mortgage bankers rely on the secondary mortgage market as the primary source of long-term investment in mortgages. Mortgage bankers make loans to borrowers and retain them only long enough to pool the loans together for sale to investors. Typically, the loans are packaged and sold as a group or "pool" of loans, or on an individual loan "flow basis." Most frequently, the resulting "pools" of loans serve as backing for mortgage-backed securities, which are sold to the ultimate investors. Accordingly, mortgage bankers are subject almost exclusively to the criteria imposed upon them

[1] MBA is the national association representing exclusively the real estate finance industry. Headquartered in Washington, D.C., the association works to ensure the continued strength of the Nation's residential and commercial real estate markets; to expand homeownership prospects through increased affordability; and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters excellence and technical know-how among real estate finance professionals through a wide range of educational programs and technical publications. Its membership of approximately 2,700 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, life insurance companies, and others in the mortgage lending field.

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by the secondary market participants, including making PMI a requirement on the loans with downpayments of less than 20 percent. These participants include the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), as well as other private investors. Thus, for mortgage bankers, almost all of the decisions regarding the status of PMI and its cancellation rest with the investors.

Within this arrangement, the originating mortgage banker may not have selected which secondary market participant, or investor, will purchase the loan by the time the loan closing occurs. As a result, it is very often difficult to ascertain at the consummation of the transaction which secondary market guidelines will apply. This uncertainty also applies to the specific requirements for cancellation of PMI. Therefore, the Committee needs to move cautiously if it intends to mandate specific disclosure requirements at the time the transaction is consummated. In most cases, this type of specific requirement cannot be accurately complied with due to the nature of the mortgage banking business. Disclosure with less specificity, however, may be accomplished without placing undue burden on the industry.

*The Mortgage Servicer*

The mortgage servicer is the party to which payments are sent, and with whom the borrower has the most frequent and direct contact. In some sense, servicers actually serve two masters: the investor and the borrower. Regarding the investor, the servicer has a fiduciary responsibility to the investor to protect the collateral. This responsibility is set forth in the contract between the parties. Therefore, the servicer is unable to cancel PMI arbitrarily unless the borrower initiates cancellation and the investor grants the servicer the authority to do so. As a general rule, the ability to cancel PMI rests with the investors. In the case of Fannie Mae and Freddie Mac, PMI waivers are specified in their seller/servicer guidelines. In the case of some of the private investors, PMI waivers appear in their servicing agreements. Although the servicer's relationship with an individual borrower is not formalized in a purely legal sense, the servicer, nonetheless, does act in a manner which is similar to a trustee in that they are responsible for collecting monthly mortgage payments and remitting principal and interest to investors, as well as the proper amounts for hazard insurance, taxes, and PMI to the appropriate parties. Functionally, servicers act as the gatekeeper for PMI. Servicers collect premiums for an indefinite period on behalf of the mortgage insurer and receive absolutely no fee income for administering this service. Servicers are still paid the same fee by the investors, regardless of whether or not a loan is insured by PMI. However, it must be noted that servicers do earn some benefit from all funds in escrow. This benefit manifests itself in compensating balances and the ability to obtain a lower interest rate on borrowed funds. These benefits, and others, translate into lower rates and fees for borrowers. Thus, the consumer does derive a financial benefit from these services.

It is also important to note that mortgage servicers are national companies. The largest servicer in the country, Norwest Mortgage, Inc., services loans from all 50 States and the U.S. Territories. In the course of its business, it deals with about 433 different investors and services approximately 1.5 million loans. Each investor has varying requirements for PMI cancellation. It is evident, therefore, that it is practically impossible to have specific disclosures identifying the PMI cancellation procedures either at the time of the transaction or later. There are simply just too many sets of different rules and procedures for a servicer to track them all with any specificity.

*The Mortgage Servicer and PMI Cancellation*

The mortgage contract typically provides an explicit duty for borrowers to maintain PMI for the life of a loan, and the courts have affirmed this. It is the exception to the rule that PMI can be canceled. Over many years, investors have become more flexible and have allowed borrowers to cancel PMI under certain circumstances, particularly if the borrower has accumulated sufficient equity in the property. Some investors believe that once such an equity position has been achieved, the risk of default has been reduced.

Generally, each investor imposes specific guidelines or conditions for cancellation of private mortgage insurance. These guidelines/conditions vary by investor and may address a number of different factors including: (1) the payment history of the borrower; (2) the age of the loan; (3) the market conditions of the area in which the property is located and whether or not the value of the property has diminished or increased; and (4) whether or not the owner resides in the property. The guidelines reflect different perceptions and evaluations of risk by investors. In order to cancel PMI, a borrower typically contacts the servicer with his/her request, and the servicer examines the current value to determine if the loan-to-value ratio (LTV) meets

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investor guidelines.[2] In virtually all cases, an appraisal is required. The prudent lender must ensure the integrity of the asset, and an appraisal is the only way to do this. Unfortunately, this can be expensive for the borrower. However, there is no alternative to the fact that this obligation must be borne by the borrower. The vast majority of investors will allow cancellation only when the following general conditions are met: (1) the LTV is 80 percent or less; (2) the borrower demonstrates an acceptable payment history; and (3) the loan has been on the books for a specified length of time.

Once again, however, it is very important to note that servicers are merely the intermediaries in this process, and have no authority to modify the pre-conditions established by investors or insurers for mortgage insurance coverage. As such, the mortgage insurance companies (MI's) must be required to bear substantial responsibility and potential liability for administering this new regime.

**The Legislation**

S. 318 amends the Truth-in-Lending Act to require automatic PMI cancellation and notice of cancellation rights with respect to those loans that require PMI. The bill requires originating lenders and servicers to disclose the following in writing:

*At the time the transaction is consummated:*

- the current private mortgage insurance ratio (based on original value at the time the transaction was entered into);
- identifying information to permit the borrower to communicate with the lender/servicer; and
- the procedures for cancellation.

*With each written statement of account:*

- the above information; or
- a written statement setting forth: (1) a declaration that the borrower "may" cancel PMI; (2) a description of the circumstances of cancellation; and (3) an address and telephone number the borrower may use to contact the lender or servicer for further information.

Lenders/servicers are prohibited from assessing any fees on borrowers to cover the costs of providing the disclosures or information. The bill also grants the lender or servicer the ability to seek reimbursement from the private mortgage insurer for any costs incurred in the provision of any information.

At the outset, MBA believes that borrowers should be apprised of their rights regarding PMI. However, the legislation may pose some administrative problems for mortgage lenders and servicers.

First, as noted earlier, at the time the transaction is entered into, the majority of lenders do not know who the investor will be for that particular loan. As a result, the lender in most instances will be unable to communicate the exact procedures available to a borrower to effectuate cancellation of PMI. Due to this inherent lack of information, we recommend the adoption of a generic disclosure statement at the time of origination.

Second, the automatic cancellation requirement, which requires the cancellation of PMI once the equity in the property exceeds the defined "private mortgage insurance ratio," is based on a specific loan-to-value ratio. Value is then based on the original value at the time of the consummation of the transaction. Servicers do not retain the data necessary to ascertain that the loan has reached a point where a borrower may have the ability to cancel his/her insurance. The original appraised value, the downpayment amount, and the LTV information generally are not maintained by servicers in their automated systems. However, we believe these data are retained by the MI's who receive the monthly insurance premiums. Therefore, in order to cancel PMI automatically, servicers would have to rely on the accuracy and veracity of the information gathered by the MI's and submitted to the servicers. In order to protect servicers, a safe harbor limiting their liability from using the information supplied by the individual insurance companies should be included in any final version of the legislation.

Third, the bill requires with each written statement of account, "a statement that the consumer *may cancel* the private mortgage insurance and a description of the circumstances under which such a cancellation may be made." Inasmuch as there is no statutory right of cancellation, MBA believes the Committee should amend the "may cancel" language to read "may be able to cancel" because not all borrowers will have necessarily met the criteria to cancel their insurance. The "may" language

[2] Loan-to-Value Ratio (LTV): The ratio of mortgage amount to appraised value or sales price of real property expressed as a percentage.

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implies that the borrower is actually able to cancel the insurance. This may not be the case. Further, a description of the cancellation procedures/criteria may be a practical impossibility. As stated earlier, each servicer serves hundreds of investors, each with their own set of cancellation requirements. Creating different computer databases for each investor requirement would not only be prohibitively expensive, but impossible to achieve. We recommend that this statement be deleted and a more generic statement inserted stating that there may be circumstances when PMI may be able to be canceled rather than the exact circumstances themselves. In addition, the requirement "with each written statement of account" poses a problem for our members who bill their borrowers monthly. It is doubtful that borrowers need to be apprised of their options regarding PMI on a monthly basis. The ability of borrowers to meet the criteria for cancellation does not change each month. Therefore, this requirement does not necessarily meet the purpose for which it was intended when monthly billing arrangements are present. Therefore, an annual disclosure would be a more feasible alternative, and MBA would urge adoption of this approach.

Fourth, the legislation enables lenders and servicers to seek reimbursement for their disclosure expenses from the private mortgage insurers. MBA appreciates this recognition. However, such reimbursement may be difficult to obtain both because quantification of such expenses may prove difficult and collection may be resisted by the MI firms. Moreover, reimbursement alone is insufficient. MBA believes there must be an explicit requirement for MI companies to release the relevant information, upon request, either to the mortgage servicer or to the consumer directly. In order for your legislative goals to be accomplished, the data must flow freely between the MI companies and the servicers. Although we support such a reimbursement concept, MBA feels that this provision needs to be examined further.

Finally, MBA believes the proposed 90-day grace period should be applied both to existing mortgages and to those entered into after enactment. The current language would make implementation more difficult and cumbersome. To eliminate any confusion, a single effective date would be preferable.

## Conclusion

In conclusion, MBA commends the Chairman for his diligent efforts to create uniform PMI disclosure and cancellation information. MBA fully supports the ability of borrowers to be apprised of their options regarding private mortgage insurance. However, the underlying objectives of S. 318 may be undermined by the costs and associated administrative burdens that may be created for mortgage lenders and servicers as they attempt to comply with the new Act. Notwithstanding our concerns, we believe the bill can be amended in a way that provides consumers with the rights and information they need, while at the same time not imposing additional and costly burdens on the mortgage servicers.

Mr. Chairman, on behalf of the MBA, I want to thank you for the opportunity to appear here today and to offer our perspective on this issue and the legislation you have introduced. We are committed to working with you and the Members of the Committee to resolve the problems you have identified in a reasonable and satisfactory manner. We would be pleased to answer any questions you may have to provide further information, as necessary, for the record.

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# PREPARED STATEMENT OF FRANK J. SUTKOWSKI

CHAIRMAN, SECONDARY MARKET SUBCOMMITTEE
AMERICA'S COMMUNITY BANKERS, WASHINGTON, DC, AND
SENIOR EXECUTIVE VICE PRESIDENT & CHIEF LENDING OFFICER
LIBERTY BANK, MIDDLETOWN, CONNECTICUT

FEBRUARY 25, 1997

## Introduction

Good morning. My name is Frank Sutkowski and I am Senior Executive Vice President and Chief Lending Officer for Liberty Bank of Middletown, Connecticut. Liberty Bank is a $1.2 billion mutual form institution, which makes it middle-sized nowadays. Liberty Bank is active as a real estate lender in both the primary and secondary markets. Single-family mortgages are a crucial asset both for delivery into our own portfolio and to the secondary market agencies. I am also Chairman of ACB's Secondary Market Subcommittee and liaison with Fannie Mae and Freddie Mac. I have been actively engaged in the issue of the timely dropping of mortgage insurance coverage both for ACB and for my own institution.

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Today I am representing America's Community Bankers, the national trade association for 2,000 savings and community financial institutions and related business firms. The industry has more than $1 trillion in assets, 250,000 employees, and 15,000 offices. ACB members have diverse business strategies based on consumer financial services, housing, and community development.

Let me begin by commending the Chairman and this Committee for addressing the issue of how to ensure that borrowers pay only for the insurance coverage that they need on their loans. I can assure you that ACB members have no stake in running that insurance past the point at which it is needed to do any good. We would prefer that the borrowers have the money as an extra cushion for debt service, for other expenditures, or, perhaps best for both depository institution lender and the borrowers, for adding to their savings and investment balances.

ACB has been working with the secondary market GSE's to ensure that their policies on private mortgage insurance (PMI) reflect current market realities and provide for the fastest possible termination consistent with their safety and soundness and the borrowers' needs. Most ACB members also retain a significant percentage of their loan originations for their own portfolios, especially of selected loan types, and have a parallel interest with the borrower in ensuring that PMI coverage is not retained when the loan-to-value ratio drops to below 75 percent. In such cases, the borrower would be paying for coverage that would not truly be in effect: in most cases, PMI covers only down to 75 percent. We would prefer the borrower to have those funds.

My own institution notifies borrowers when we believe PMI can be safely dropped. We go through continuous portfolio review to ensure that we alert customers when, through either regular loan amortization, special principal paydown(s), or property price appreciation, that PMI coverage can be dropped. A sample customer alert letter is attached to my statement.

We have to recognize, however, that PMI coverage deals with a very real threat to lenders' financial stability and to customers' credit histories. Unfortunately, real estate market values do not always move steadily, or even sporadically, in an upward direction. There was a rather painful reeducation of lenders at the start of the 1990's for some historically very strong markets. On both coasts, in California and Connecticut, property values took a very sharp correction and only recently is a solid recovery taking hold. My institution still can show more loans than we would like with 5 years' seasoning and "upside down" values, i.e., where the current property value is less than the original sales price.

Regular loan amortization is a slow process, though a fraction faster at today's rather moderate rate levels than at the double-digit coupons of the 1970's and 1980's. The main driving force in substantial early improvement in loan-to-current-value ratios is property price appreciation. Even healthy markets will take some time to bring a 95 percent loan down to the 80 percent or 75 percent level where lenders feel comfortable with PMI termination.

From the borrower's perspective, of course, it is normally a case of the-sooner-the-better. It is clearly the case that, where PMI would not be required were the loan outstanding to be newly underwritten, appraised, and originated, the PMI on the loan should be dropped. However, getting the loan-to-value (LTV) ratio to that point will take some time, generally in excess of 10 years. Especially because most loans have a life of less than 10 years, fewer loans become eligible for PMI cancellation each year than one might think. For instance, my bank's rather exhaustive procedures recently identified only 3 percent of the loans on our books as candidates for PMI cancellation.

Under regulatory guidance for depository institutions, where the real property is the sole collateral securing a conventional loan, PMI will be routinely required for LTV ratios of 90 percent and above. Most lenders, however, will generally require PMI on loans exceeding an 80 percent LTV threshold. Secondary market standards drive the PMI practices of mortgage bankers who deliver all their product to investors. Those secondary market standards also affect what portfolio lenders do because often some part of their production will be sold also, either immediately or after some seasoning.

The secondary market Government Sponsored Enterprises (GSE's) were major beneficiaries of PMI coverage. We understand that at the depths of the real estate problems in the Southwest, pay-offs from PMI companies exceeded the earnings of the GSE's, which would therefore have operated at a loss had it not been for their foresight in requiring this coverage.

ACB appreciates the sensitivity that you demonstrated, Mr. Chairman, when you introduced your bill, S. 318, to the legitimate role of this insurance coverage and to focusing on how to ensure that termination does not add to credit risk exposure.

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S. 318 deals with the approach to a threshold LTV ratio, apparently concentrating on the regular amortization process.

I would like to offer a few comments on S. 318 here, while reserving the more technical issues for the appendix to this statement. First, S. 318 focuses on the original LTV, not the loan-to-current-value ratio. With regular amortization, a long enough period will normally elapse for the "upside down" status of original and current property values to correct themselves, especially in cases where a significant partial prepayment has been made by the borrower. However, where the property value has unfortunately dropped also, the real loan-to-value ratio may not hit the desired trigger point.

This type of complexity is what ACB and others have been addressing in discussions with Fannie Mae. In certain early borrower-initiated PMI cancellation requests, Fannie Mae has proposed that the servicer warrant that the current value of the collateral property is at least as great as at the time of the loan origination. Such a representation would be backed by a required, limited scope "exterior only" appraisal of the overall condition of the property and a review of price trends for comparable properties in the area.

Those discussions have also raised the possibility of an approach where an automatic lender/investor waiver of the continuation of PMI would be triggered by the passage of half the loan's scheduled maturity, i.e., for a 15 year loan PMI would automatically drop after 7½ years, and after 15 years for a 30 year loan. This "fail-safe" provision would allow some reasonable opportunity for any "upside down" properties to be placed on a better financial footing by the reasonably foreseeable long-run price appreciation that usually characterizes real estate markets.

ACB also hopes that we can discuss the 80 percent "hardwired" value of S. 318. Most PMI coverage goes down to a 75 percent value, and for some properties the required coverage goes even deeper. Again, the maximum term of loan half-life, by implicitly mixing price trends and paydowns, may be an advantageous alternative with benefits for both lender and borrower.

Both sides of the loan transaction would also benefit from user-friendly and efficient notification of PMI cancellation options. Obviously, it is appropriate that the borrower be given specific information as to the conditions under which PMI will be required on the loan, and an appropriate notice at the time of the loan closing is completely acceptable. (There is a separate issue about certain loans where the borrower elects to have the lender pay for the PMI coverage rather than buy it separately; this approach can have tax benefits to the borrower and is covered in the appendix).

ACB, however, is concerned that the potential required frequency of notices under S. 318, as drafted, may confuse rather than help customers. There is an obvious case for supplementing that up-front disclosure with periodic reminders. S. 318 requires notice in or with each account statement, but not less than annually. The literal language of S. 318 would require many lenders to make monthly disclosures, starting with the first regular payment month. Many institutions have moved from coupon books to monthly statements, even those using direct debit to the borrower's checking account by standing order. Such institutions may then feel obligated to provide the recomputed loan-to-original-value ratio if a notice is required every month even though, rounded to two decimals, the percentage would not be shifting perceptibly from month to month in the first years.

Simplifying the requirement in S. 318 that the notice be no less than annual could be a more practical approach and enable coordination with other annual reports to consumers such as their Federal tax information returns. It would also avoid borrowers becoming unduly affected by the inevitable tendency to skip over "boilerplate" disclosures that become routine. Also, it would most likely be worthwhile to consider giving lenders the option, within any solution to this public policy and consumer issue, of skipping the notices for the first 2 years of the loan life. Regular amortization is not going to reduce the LTV that quickly and borrowers will tend to pay more attention when they are given a "heads-up" that they can potentially really use.

Avoiding the issuance of notices until they are relevant for the consumer will enable this issue to be addressed in the most cost-effective way. ACB welcomes the initiative in S. 318 to protect both borrowers and servicers from the added costs of providing disclosures. As a practical matter, however, it would still be difficult for a lender/servicer to pass the cost for existing loans to either the consumer or the PMI carrier since the servicer is bound by an existing contract in both cases. For both the transition period and the long-run, economizing on costs by making the notices visible enough to be useful to the consumer and targeted enough to be manageable on the business side is clearly the best way to go. Ultimately, on new business in a highly competitive and thin margin market, even these optimal level costs will

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be borne by the consumer as market pricing adjusts. It is a shared goal that the consumer benefit from these costs be as large as possible.

It is not a trivial task to handle the real world process of notifying customers that price trends have made it worth their while to check whether a reappraisal can justify dropping their PMI. A system is needed to handle the entire process, from setting up the review cycle, ordering the appraisal, collecting the fee, recording the results, determining whether PMI can be canceled (which is not set be an absolutely inflexible pass/fail test at my institution), notifying the insurer of cancellation if that is the outcome, and adjusting the loan file accordingly.

Attached is the step-by-step workflow from my institution's procedures manual. As I indicated, my institution is willing to be flexible to help a good customer. If the appraisal produces a loan-to-current-value ratio a fraction away from the target ratio, for a customer with a good payment history in a reasonably solid real estate submarket, we will often let the PMI be dropped to avoid the appraisal fee being wasted and having to go through the exercise all over again a year later. We can offer this flexibility as a portfolio lender. When we have sold the loan into the secondary market, as only the servicer we have to work under the investor's standards. This is why we have been eager to work with the GSE's.

As lenders, ACB members find that the driving force in most PMI cancellation requests from customers is property price appreciation. The average loan life is less than the period required to bring the loan-to-original-value below the termination threshold by regular amortization alone. Accordingly, ACB has been engaged in private sector efforts, especially with Fannie Mae, to address this topic in a truly comprehensive way.

## Conclusion

ACB again commends the Chairman and the Committee for raising the profile of a real consumer issue. ACB is deeply committed to resolving this issue to the satisfaction of the public and of Congress. We welcome continued congressional oversight of the lending community's efforts to produce an achievable private sector solution through standards that actually go well beyond the situations covered in S. 318. ACB recognizes that industry efforts must come to fruition very quickly. Legislation early in this Congress is always an option, and the industry approach, to qualify as an acceptable alternative, has to do more. The public deserves no less.

As indicated at various places in this statement, a number of more technical issues are covered in an appendix. I would be happy to address any questions that you may have. Thank you for this opportunity to offer our views on this important topic.

### Appendix: Technical Comments and Observations

1. Different LTV settings may be appropriate for different loan types. In borrower-initiated cancellation requests where a full-scope reappraisal has been performed to validate price appreciation (as well as loan paydown) to reduce LTV, Fannie Mae has discussed setting a lower value for investor-owned or second home property than for the borrower's principal residence. The borrower's payment motivation is less in these cases, as objectively demonstrated by default and foreclosure rates across the full range of market conditions.

2. The prohibition in S. 318 on requiring PMI coverage on the property whenever the borrower has *any* equity in excess of the level set as the PMI cut-off point (New Section 126(a)(1) of the Truth-in-Lending Act: "private mortgage insurance ratio") could indeed adversely affect both safety and soundness and credit availability. Requiring such PMI on so-called "low doc" loans where, for speedy processing or other reasons, a normal, full data set of borrower information is not secured may be essential. Alternatively, for a borrower who can manage a reasonable downpayment but whose income is such that normal debt service ratios are strained, again PMI can make the customer "bankable." Admittedly, these are situations of the type contemplated by the exception authority given to the Federal Reserve (New Section 126(a)(2)(B)(i) and (ii)). Again, however, flexibility in setting the "private mortgage insurance ratio" across various loan types, as noted above, is desirable.

3. Price appreciation is the major driver of the early PMI cancellation opportunity. On a 95 percent LTV, 30-year, 7 percent fixed-rate loan, it takes 13 years 2 months to reach a 75 percent LTV, relying on regular loan amortization alone. With only 4 percent annual price appreciation on the property, a 75 percent loan-to-current-value ratio is achieved in less than 5 years.

4. Under certain circumstances, it is advantageous for the borrower to pay a higher interest rate on the loan, say 0.25 percent, with the understanding that the *lender* use that quarter point to cover the cost of the PMI. In this way, the borrower

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is paying a higher, but appropriately risk-adjusted, interest rate. Interest secured by the home is, however, unlike borrower-paid PMI premiums, deductible to the borrower. In secondary market transactions, the gross interest rate is used for pricing the transaction: transactions are done on a net-of-servicing investment return to the buyer. PMI cancellation options can cover only borrower-paid premiums. On the other hand, the sophisticated borrower who expects to sell the home or refinance based on interest rate movements or price appreciation may very well prefer the tax advantage.

Other non-standard products are also appearing in the mortgage marketplace. For the sophisticated borrower who, by contrast, does not want to refinance (or sell the home) but who does want the major tax advantage of maintaining a fully-financed property, lenders are beginning to offer an interest-only loan: the excess payment that is collected over the periodic interest goes to the acquisition and buildup of an endowment insurance policy that will accumulate to an amount that will pay off the mortgage at maturity, with an attractive package of credit and mortality risk coverage in the meantime. Markets and products do evolve to meet consumer needs and niches.

5. Appropriate setting of the frequency of the consumer disclosures is critical, as noted in the main text. It is also essential to allow lenders/servicers some flexibility in the (suggested annual) notice provided to borrowers. To minimize unnecessary costs to the benefit of all concerned, it would be helpful to allow the coordination of the notice with other special mailings from the servicer.

One obvious candidate is to combine the PMI notice with the annual escrow accounting required under RESPA. The advantage of this combination is the flexibility that it offers to the servicer to smooth the production and transmission of the notices across the year, e.g., by processing one twelfth of the portfolio every month. If the notices are having their intended effect, they will produce borrower response and phone/mail inquiries. Avoiding "peak load" congestion is desirable.

This would be a problem with the use of the IRS Form 1098 information reporting on mortgage borrowers since that workload is heavily concentrated in January/February every year. Of course, every borrower gets an information return while not all receive escrow analyses because some lenders have abandoned the practice of escrows since the mandated switch to aggregate rather than line item reserving under RESPA. Unfortunately, the physical format of many computer-generated self-mailer 1098 Forms is not conducive to expanded data and verbiage.

Annual notification rather than mandated addition to every periodic statement is important because it would be essential (to avoid unnecessary inquiries from borrowers who have not yet reached the approved PMI cancellation threshold on either an original or current market LTV basis) to include an indication of at least the original basis LTV. This is not a trivial systems or programming issue, especially for volume lenders. These lenders, to speed up the processing of monthly payments, select only the minimum required data fields for that computing cycle and would have to reprogram and potentially reschedule workflows or add computer capacity because these operations are run on a time-sensitive, production-line basis.

6. When PMI is canceled, the borrower naturally saves on its cost. Normally, the saving takes the form of avoiding a monthly insurance fee. If the PMI cancellation is accelerated by property price appreciation and there's the need for a full-scope reappraisal, at an expected $300 cost for that appraisal, the borrower's payback period for that outlay is approximately 7 months. The borrower may also have a modest balance for this item within the overall, larger escrow balances maintained for property taxes and hazard insurance. In the event that these escrow balances are in deficit, as is more likely with the recently mandated aggregate method, the lender/servicer should be able to apply any PMI escrow balance at PMI termination to that deficit.

7. In some cases, the PMI cost was covered by a single up-front premium for the coverage, as was the practice for a time with FHA insurance. In most such cases, to reduce the up-front cash to close, that premium was added to the required loan proceeds and financed. In those cases, the borrower will not see the benefit of a lower monthly payment, but will receive a lump sum rebate of the unearned premium. In a present-value sense, using the loan coupon as the discount rate, the benefit of the PMI termination is the same but the cash flow profile is different.

Finally, while mentioning FHA insurance, it would be helpful for the FHA to provide an economic or policy rationale for an exception of their regular 203(b) insurance program from termination requirements.

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Dear __________________________:

Upon reviewing your file we noticed that you may be eligible to cancel your PMI (Private Mortgage Insurance). The loan to value ratio requirement for a waiver is 80%. Your principal balance must be equal to or less than 80% of the market value of your home. A full appraisal is required to determine the current market value of your home. There is a non-refundable $________ fee for the appraisal which will be conducted by an outside agency to ensure objectivity.

If the results of the appraisal show that your current loan to value is 80% we will be happy to waive your insurance requirement. Please call me at ______________________ if you have any further questions or to have the necessary paperwork sent to you.

Sincerely,

Loan Service Department

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PMI (PERSONAL MORTGAGE INSURANCE) PROCEDURES

**LIBERTY BANK**

**PRIVATE MORTGAGE INSURANCE (PMI) WAIVER**

**GUIDELINES AND PROCEDURES**

**Revised June 1,1996**

At the time of loan closing, a Mortgage Insurance Disclosure form and/or a mortgage payment schedule is signed and acknowledged by each respective customer.

The following represents established criteria to be conformed to in granting a PMI waiver request:

- The loan must have been in existence for at least twelve (12) months.
- The loan must have no late payments during the past twelve (12) months.
- The loan-to-value ratio requirement for a waiver is 80%.
- A full appraisal is required for all PMI waiver requests.
- An outside agency conducts the appraisal; the Bank does not use internal appraisers, nor does the customer select their own appraiser.
    - Note: In each case, the original appraiser may not be utilized. This serves to ensure proper objectivity.
- The processing fee for a PMI waiver request is $300.00 , which represents appraisal and administrative costs. This processing fee is non-refundable.
- The PMI waiver letter must be customized and two (2) copies mailed to the borrower(s) requesting the waiver. (See Attachment 1)
- The borrower(s) must sign and return one copy of the letter and the $300.00 fee.
- Forward the signed letter and check to the Loan Services Department, where they will order and track the appraisal request.
- The average turnaround time for a PMI waiver request is ten (10) business days.
- Any questions concerning this policy may be directed to the Loan Services Department or the Customer Service Manager.



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# PMI (PERSONAL MORTGAGE INSURANCE) PROCEDURES

## 1. OVERVIEW

PERSONAL MORTGAGE INSURANCE IS OBTAINED WHEN A CUSTOMER DOES NOT HAVE A DOWN PAYMENT OF AT LEAST 20% OR MORE. LIBERTY HAS 4 COMPANIES HANDLING OUR PMI ACCOUNTS:

| CODE | COMPANY |
|---|---|
| 231 | PMI (PRIVATE MORTGAGE INSURANCE) |
| 232 | MGIC (MORTGAGE GUARANTY INSURANCE CORP. |
| 233 | UGI ( UNITED GUARANTY) |
| 235 | GE (GENERAL ELECTRIC) |

## 2. PAYMENTS

PAYMENTS ARE PULLED MONTHLY OR ANNUALLY FROM THE CUSTOMERS ESCROW ACCOUNT. ORDER A NON - RUN UPDATE ( GREEN BAR)FROM INFORMATION SERVICES USING FORM LNM 204 ( SEE ATTACHMENT # 1) FOR EACH OF THE COMPANIES ABOVE. MATCH TO THE COMPANY BILLING STATEMENT.

IF ACCOUNT IS ON THE NON-RUN TO BE PULLED BUT NOT ON BILLING SET UP ON THE COMPUTER TO PULL FOR NEXT MONTH WHEN BILLING WILL BE SET UP. THIS IS DONE BY GOING INTO FREE FORM USING SA/MLTRL THEN ENTERING IN TRANSACTION CODE 06, APPLICATION CODE, ACCOUNT NUMBER NUMBER , PROP CODE 01 AND DISB CODE 31. CHANGE DATE IN THE COMPUTER FROM CURRENT MONTH TO NEXT MONTH.

IF ACCOUNT IS ON THE COMPANY BILLING BUT NOT ON THE NON- RUN UPDATE ( GREEN BAR) FILL OUT LOAN TICKET USING CODE 1219 OR 1220 (NEGATIVE ESCROW PULL) AND REASON CODE OF 31 TO PULL AMOUNT MANUALLY FOR PAYMENT BY TELLERS OR CHANGE THE SET-UP ON COMPUTER SO IT WILL PULL.

IF ACCOUNT IS ON THE COMPANY BILLING TWICE ( 2 MONTHS ARE OWED TO COMPANY) AND ONLY 1 PULL IS ON NON-RUN UPDATE ( GREEN BAR) FILL OUT A LOAN TICKET USING CODE 1219 OR 1220 AND REASON CODE OF 31 FOR THE AMOUNT OF 2ND PAYMENT TO BE PULLED MANUALLY BY TELLERS. **NOTE: KEEP LIST OF THESE ACCOUNT NUMBERS BECAUSE AFTER TELLERS PULL THEM MANUALLY THE DATES WILL HAVE ADVANCED TO 2 MTHS AWAY SO WE WILL HAVE TO CHANGE THEM BACK TO PULL FOR THE NEXT MONTH DUE.**

ORDER ANOTHER NON -RUN UPDATE DONE ON THE ACCOUNTS BY SENDING THE TOP SHEET WITH THAT REQUEST ON IT TO INFORMATION SERVICES. THAT WILL PUT INTO EFFECT THE COMPUTER CHANGES YOU HAVE ENTERED.



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PMI (PERSONAL MORTGAGE INSURANCE) PROCEDURES

UPON RECEIVING THE NEW NON-RUN UPDATE ADD THE LOAN TICKETS TO THE TOTAL AND IT SHOULD EQUAL THE BILLING STATEMENT FROM COMPANY.( IF MORE CHANGES ARE MADE FOLLOW THE PREVIOUS INSTRUCTIONS AND FOLLOW UP CORRECTIONS WITH ANOTHER NON-RUN UPDATE).

ORDER BY SENDING THE TOP SHEET OF NON-RUN UPDATE AND THE ALTIN TO INFORMATION SERVICES REQUESTING A RUN -UPDATE OF THE ACCOUNTS SO THEY WILL BE PULLED FROM CUSTOMERS ESCROW ACCOUNTS FOR PAYMENT.

WHEN YOU RECEIVE THE PULL BACK FROM INFORMATION SERVICES. FILL OUT DEBIT TICKET GL # 2710-4773-20 PMI ESCROW FOR THE AMOUNT OF TOTAL ON THE GREEN BAR .THIS DEBIT AND LOAN TICKETS ADDED MUST EQUAL COMPANY BILLING TOTAL.

MAKE OUT A CHECK TO COMPANY FOR AMOUNT OF THIS TOTAL AND SEND IT, WITH THE REMITTANCE COPIES OF BILLING TO THE COMPANY.

GIVE PINK AND WHITE COPIES OF CHECK TOGETHER WITH DEBIT AND LOAN TICKETS TO THE TELLFRS FOR PROCESSING.

**3. PMI WAIVER**

CUSTOMER CAN REQUEST THAT PMI BE WAIVED. IN ORDER TO WAIVE PMI CUSTOMER HAS TO MEET THE SPECIFIED REQUIREMENTS IN THE PMI POLICY AND GUIDELINES (SEE ATTACHMENT 1). I USUALLY EXPLAIN THE PROCEDURES TO THEM AND THE FACT THAT THE FEE INVOLVED IS NON-REFUNDABLE SO A LITTLE MARKET ANALYSIS DONE ON THEIR OWN IS WISE BEFORE SENDING THE CHECK.

**EXCEPTION**

**IF A LARGE PRINCIPLE PAYMENT IS MADE CHECK WITH BOB STEELE OR ADELA BERNARD. WE MAY BE ABLE TO REMOVE PMI WITHOUT APPRAISAL BEING CONDUCTED.**

2 LETTERS ARE SENT TO CUSTOMER (SEE ATTACHMENT 2) STATING WHAT THE APPRAISAL VALUE HAS TO BE AND INFORMING THEM OF FEE REQUIRED. ONE TO BE SIGNED AND RETURNED WITH THE $300.00 CHECK.

UPON RECEIPT OF CHECK FOR FEE AND SIGNED LETTER REQUESTING THE PMI WAIVER AN APPRAISAL OF PROPERTY IS ORDERED TO BE CONDUCTED ON THE PROPERTY BY ONE OF OUR APPROVED APPRAISERS (NOTE NOT THE ONE USED FOR ANY PREVIOUS APPRAISALS DONE).



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PMI (PERSONAL MORTGAGE INSURANCE) PROCEDURES

THE CHECK FOR $300.00 IS CREDITED TO COMPUTER SUSPENSE ACCOUNT 1990-00-7320. COPY TO ANNE PILLARELLA. GIVE TO TELLERS TO PROCESS.

IF APPRAISAL COMES BACK WITH 20% EQUITY PMI MAY BE WAIVED IF NOT CUSTOMER MAY PAY DOWN PRINCIPAL IN ORDER TO QUALIFY.

CUSTOMER IS NOTIFIED BY LETTER (SEE ATTACHMENT 3) THAT PMI IS BEING REMOVED (I ALSO USUALLY CALL JUST TO BE MORE PERSONABLE) AND THAT A COPY OF THE APPRAISAL IS BEING SENT TO THEM AND THAT AN ESCROW ANALYSIS WILL ALSO BE SENT.

## 4. DELETING PMI OPERATIONAL PROCEDURES

CANCEL PMI BY FILLING OUT APPROPRIATE PAPER WORK OF COMPANY THAT PMI WAS SET UP WITH (SEE SAMPLE 1).

FILL OUT PROPERTY FIELD CHANGE SHEET, USING TRANSACTION 1376 USING REASON CODE 31 (SEE SAMPLE 2).

SET FLAGS FOR NEW ESCROW ANALYSIS (SEE SAMPLE 3) TO BE RUN. AND REMOVE FLAG 32 1365 FLAG TYPE OTHER 3.

APPRAISER IS PAID BY SUBMITTING BILL TO ACCOUNTING WITH GL NUMBER COMPUTER SUSPENSE 1990-00-7320 TO BE DEBITED NOTED ON THE BILL. SIGNED BY ADELA, JANET ETC. COPY TO ANNE PILLARELLA

DEBIT 1990-00-7320 COMPUTER SUSPENSE ACCOUNT FOR $50.00 WITH DESCRIPTION BEING PMI WAIVER AND ACCOUNT NUMBER. CREDIT INCOME ACCOUNT 3570-007340 FOR $50.00 WITH DESCRIPTION PMI WAIVER AND ACCOUNT NUMBER. GIVE TO TELLERS TO PROCESS. COPIES OF DEBITS AND CREDITS TO ANNE PILLARELLA.

UPON RECEIVING ESCROW ANALYSIS SEND ONE COPY TO CUSTOMER AND PLACE ONE IN CUSTOMERS FILE. MAKE COPY OF SIGNED TOP COPY AND GIVE TO ANNE PILLARELLA WRITE ON COPY FOR ANNE SHORT ESCROW.



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## PREPARED STATEMENT OF BRIAN L. McDONNELL

PRESIDENT/CEO, NAVY FEDERAL CREDIT UNION, VIENNA, VIRGINIA

FEBRUARY 25, 1997

My name is Brian L. McDonnell. I'm the President and Chief Executive Officer of Navy Federal Credit Union. I am here today to speak on behalf of the National Association of Federal Credit Unions (NAFCU), the Credit Union National Association (CUNA), and Navy Federal Credit Union to express my credit union's support and that of thousands of other credit unions represented by CUNA and NAFCU for the proposed "Homeowners Protection Act of 1997" (S. 318).

Mr. Chairman, Navy Federal, NAFCU, and CUNA applaud your efforts and those of Representative Hansen in introducing legislation which clearly informs existing and future homeowners that private mortgage insurance (PMI) may not be required for the full term of the mortgage contract. Navy Federal has granted mortgage loans to our members since 1979. Our experience over this time period has shown that PMI cancellation requirements are confusing to many members, despite our best efforts to disclose these requirements. We believe that this legislation will increase the awareness of many of our members and millions of other homeowners who mistakenly have taken for granted that PMI premiums are required for the life of the mortgage loan. Our credit union, as is true with most businesses, knows that full disclosure and keeping members well-informed increases their satisfaction with the services we provide.

Navy Federal—like all other credit unions—is a member-owned, not-for-profit financial institution. Members are the heart of a credit union, the very reason for a credit union's existence. Credit unions are organizations of people. There is no group of stockholders for whom profits must be generated. Credit unions are democratically controlled by their members through volunteer officials and an unpaid board of directors elected by the membership. Credit unions stand in sharp contrast to profit-oriented intermediaries in the financial services industry.

The motto of credit unions is **not for profit, not for charity, but for service.** This motto captures the essence of credit unionism. Although a positive bottom line is important for economic viability, credit unions focus on directly serving their individual member-owners. This characteristic distinguishes credit unions from other financial institutions.

Navy Federal Credit Union today serves 1.6 million members worldwide through our 84 member service centers. Our membership is mostly comprised of personnel from the Department of Navy, including the U.S. Navy and U.S. Marine Corps, and their dependents.

Since we first began offering mortgage lending service to our members in 1979, Navy Federal has provided over 110,000 mortgage loans, totaling $12.6 billion, to help our members realize their goal of homeownership. Currently, we service over 63,000 mortgage loans, valued at $6.2 billion. We provide mortgage lending service on residential properties located in all 50 States and the District of Columbia.

Since the inception of Navy Federal's mortgage lending operation, we have been active in the secondary mortgage market. This means that Navy Federal sells and services mortgage loans for investors, such as Fannie Mae, Freddie Mac, Ginnie Mae, and private investors. Selling our mortgage loans to secondary market investors allows Navy Federal to avoid the interest rate risk that comes from holding long-term mortgage loans in portfolio and to recycle our capital into additional loans to our members.

Because of the requirements of the purchasers of Navy Federal's mortgage loans, we require PMI coverage when the member provides less than a 20 percent downpayment. As you probably know, mortgage lending industry data clearly shows that the lower the downpayment, as a percentage of the property value, the greater the risk of the loan to default. PMI allows lenders to better manage the risk of granting mortgage loans with low downpayments, while permitting potential homebuyers who choose not to make a higher downpayment to achieve the dream of homeownership. Therefore, PMI plays a pivotal and valuable role in the mortgage lending process. PMI fulfills a critical need, both for many first-time homebuyers, as well as for those members who have low-to-moderate incomes and limited resources to apply toward a downpayment for a mortgage loan. Without the availability of PMI, these low-to-moderate income members would be unable to obtain conventional mortgage loans to finance the purchase of a home. In addition, PMI allows certain members to purchase a home even though they elect not to use available funds to make a larger downpayment.

Though we sell our loans to secondary market investors, we always retain the loan servicing. Our members continue to deal directly with their credit union for the

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life of the loan, even after their loans have been sold. This means we collect and distribute the principal and interest, escrows for real estate taxes, homeowner's and flood insurance, and PMI. The total PMI premiums collected from our members are passed directly to the PMI companies. We receive no administration fee from the PMI companies.

We are very concerned about saving our members money and protecting their interests, as well as protecting our investors. Therefore, it has been our policy to monitor the outstanding loan balances of our members' loans with PMI to ensure that they are not paying for PMI coverage when it is no longer required. This typically means that once the loan balance represents 80 percent or less of the original value of the property, Navy Federal automatically cancels the PMI on behalf of our members. We do not send a notice to our members requesting approval to cancel the insurance. We simply cancel it and notify our members by mail that the PMI is no longer necessary and has been canceled. This letter also advises our members of the reduction in their monthly payment resulting from the cancellation of PMI. We have been automatically canceling PMI for our members since we began offering mortgage loans in 1979. At present, Navy Federal cancels about 40 PMI premiums per month as a result of monitoring our members' outstanding principal balances.

You may wonder why we do this. The first—and most important—reason is that we are a credit union dedicated to serving the needs of our members. Navy Federal members are very loyal to their credit union. This is reflected in our low loan delinquency experience in our mortgage loans and consumer, credit card, equity, and Federal education loan programs. We look for ways to repay the loyalty of our members by offering them low rates on loans, competitive rates on savings accounts, responsive and convenient service, and limiting the fees charged to members.

Another reason we can automatically cancel PMI for our members is that it's easy to determine when a mortgage loan reaches 80 percent loan-to-value or the required ratio established by the investor. Our automated system provides us with a monthly report of the loan-to-value ratio of each loan. If the loan-to-value ratio has reached the level at which PMI can be canceled, then we forward a letter to the member notifying them that the PMI has been canceled and that the monthly payment has been reduced.

Navy Federal does not verify that the property is currently occupied by the owner, nor are we concerned that property values are stable or decreasing. We believe that when the member obtained the mortgage loan with PMI from us, we struck a bargain with the member regarding the PMI requirement. The member understood that PMI was required because the downpayment was less than 20 percent. When the accumulated equity in the property reaches 20 percent, we think the members expect their credit union to cancel the PMI. Most members have faithfully made payments on time, and some have made additional payments to reduce the outstanding loan balance. We believe they have fulfilled their end of the bargain, i.e., made payments to reduce the balance of their loans as required. By automatically canceling the PMI, we are fulfilling our end of the bargain. Our investors have never expressed any reservation about Navy Federal automatically canceling the PMI requirement.

It is also quite common for members to contact us about discontinuing PMI *prior to* their loan balances reaching the ratio level necessary to cancel the insurance. We explain to these members that their current loan balance, compared to the original value of their home at the time of loan origination, does not presently allow us to cancel the PMI. However, we carefully explain to those members the actions which would allow cancellation of PMI. Members may obtain a new residential property appraisal, using a Navy Federal approved appraiser, if they feel the property value has appreciated due to market conditions, improvements made, or both. The appraisal cost averages $300 nationwide. If the appraisal establishes a higher value, decreasing the loan-to-value ratio to 80 percent or less, Navy Federal will cancel the PMI on behalf of the member.

In the event a loan has not paid down to the required ratio level, we inform the member about the investor's requirements for canceling PMI. For example, Fannie Mae—the Nation's largest secondary market entity—requires that a member's loan balance be reduced to 80 percent of the property value and that the member must have been current for the previous 12 months. Freddie Mac requires that members make mortgage payments on time for the previous 24 months. Private secondary market investors generally require the loan-to-value be reduced to 75 percent, not 80 percent, before PMI can be canceled.

In summary, Mr. Chairman, Navy Federal, NAFCU, and CUNA support the proposed "Homeowners Protection Act of 1997." We would recommend clarification of some of the technical definitions incorporated in the bill, but this is basically good legislation which will save homeowners money without jeopardizing the mortgage

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lender. We hope that the legislation can be kept simple for lenders to implement and, therefore, easy for credit union members to understand. The credit union movement stands ready to provide assistance to see that this legislation becomes law.

Mr. Chairman, this concludes my prepared statement. Again, I wish to thank you on behalf of Navy Federal, NAFCU, and CUNA for the opportunity to express our views on this proposed legislation. I look forward to answering any questions that Members of the Committee may have.

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**RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO FROM R. LAYNE MORRILL**

**Q.1.** In your written testimony to the Committee, you suggest that "the private mortgage insurer should be disclosed to the homebuyer at settlement, despite the fact that a mortgage insurer's client is the lender, not the homebuyer." Why do you think this would be necessary?

**A.1.** In short payoff sales, where a lender agrees to the sale of a property for a price less than what is necessary to fully repay the mortgage balance, the PMI provider can become the homeowner's ally because it is in the interest of the mortgage insurance carrier to avoid foreclosure. REALTORS® often helps clients selling or buying short payoff properties and it is helpful to know the mortgage insurance carrier to facilitate negotiations with lenders. PMI carrier disclosure at settlement would not create an additional cost to lenders and it could be a critical element in facilitating a transfer of real estate in short payoff sales.

**RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO FROM KENNETH L. NICHOLSON**

**Q.1.** Assuming that the PMI cancellation is based on the appraised value of the house at closing, do you think it would be useful to provide homebuyers with an estimate, at closing, of when they would be able to terminate PMI (assuming a loan-to-value ratio of 80 percent or less) by using an amortization schedule based on the terms of the mortgage? Why or why not?

**A.1.** Yes. The appraised value of a home at closing as determined by a qualified appraiser utilizing industry standards will provide a reliable benchmark from which to project a likely date for PMI termination. Such an amortization schedule based upon the term of the mortgage, the interest rate, and any other relevant facts should be readily determinable and available at closing.

**RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO FROM WILLIAM H. LACY**

**Q.1.** What are the average monthly PMI payments?

**A.1.** Private mortgage insurance offers homebuyers a broad spectrum of premium alternatives, ranging from renewable monthly premiums (Monthlies) to a single up-front premium (Singles) to renewable annual premiums. In addition to the type of private mortgage insurance (PMI) premium plan selected, four other factors influence the amount of premium:

1. The loan amount.
2. The loan type and term.
3. The loan-to-value (LTV) ratio at origination, which determines the depth of coverage.
4. The age of the policy.

Using the 1996 median house price of $119,000 and a 30-year fixed-rate mortgage (FRM), a borrower who makes a 10 percent downpayment would pay a monthly premium of about $45. If that same borrower makes a 5 percent downpayment, he or she would pay a monthly premium of about $70.

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Monthly premiums on policies older than 10 years are substantially less. This is because mortgage insurance premiums are structured to account for the fact that older policies generally pose less risk of foreclosure.

**Q.2.** What is the duration of an average PMI policy? How long do most consumers actually make PMI payments? Please estimate what percentage of homeowners request cancellation of their policies when they reach the determined equity level. How common is it for homeowners to cancel PMI before the 80 percent loan-to-value ratio is reached by having a new appraisal done or by other means?

**A.2.** On average, a mortgage insurance policy remains in force for slightly less than 4 years. Once a policy is canceled by the insured party (the lender or secondary market investor), the borrower is no longer required to make premium payments.

Requests to cancel PMI are made by borrowers directly to mortgage servicers. As a result, insurers are not privy to the number of cancellation requests servicers handle or the results of the requests. There are primarily four reasons for a policy cancellation:

1. A mortgage is paid in full.
2. A mortgage is refinanced.
3. A mortgage goes through foreclosure and a claim is paid by the insurer.
4. An investor has agreed to cancel PMI because certain cancellation provisions were met by the borrower and/or warranted by the servicer.

Given that policies only remain in force for an average of slightly less than 4 years, having been canceled for a variety of reasons, very few amortize to 80 percent LTV. At current interest rates, it takes approximately 10 years for mortgages with original LTV's of 90 percent to amortize to a LTV of 80 percent, and approximately 12 years for 95 percent LTV mortgages to amortize to 80 percent. Furthermore, over 87 percent of the entire insurance-in-force of the private mortgage insurance industry is less than 5 years old.

**Q.3.** What is the risk of default on a mortgage loan which has a loan-to-value ratio of 80 percent or less?

**A.3.** It is difficult to directly answer this question since mortgage insurers generally do not have the information necessary to calculate a loan's current LTV. However, based on our experience in monitoring real estate market fluctuations, we believe lenders and secondary market investors would be exposed to substantial risk if policies were automatically canceled at 80 percent LTV. Today, private mortgage insurers bear this risk, minimizing or eliminating losses to lenders and secondary market investors. Let's explore the two most prominent reasons that automatic cancellation based on achieving a LTV of 80 percent or less would be problematic:

1. *Property values appreciate before dropping sharply.* The mortgage industry's recent experience with significant depreciation in property values in Southern California, the Northeast, and the Oil Patch States suggest there is peril in automatically canceling private mortgage insurance on loans with LTV's of 80 percent or less. Often in real estate, periods of rapid prop-

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erty appreciation—which reduce LTV's—are followed by sharp drops in values—subsequently increasing LTV's and, therefore, the risk of foreclosure. For example:

A. In Houston, Texas, between 1983 and 1988, property values declined 27 percent after rising 21 percent the prior 3 years, causing a rash of foreclosures. In fact, the rate of foreclosures in Houston was nearly triple the rate of foreclosures experienced by the entire Nation during the Great Depression.

B. More recently, Southern California has been beset by falling property values following a period of significant home price appreciation. In Los Angeles County, property values fell 29 percent between 1990 and 1996 after increasing 62 percent from 1987 through 1989. In fact, in Los Angeles, the foreclosure rate of 1988 insured originations is running at more than twice the MI industry's foreclosure rate since LTV's fell below the 80 percent threshold sometime in 1989.

C. While the Oil Patch States and Southern California are very striking and well-publicized examples of what can happen when property values decline sharply, the same scenario has played out to a lesser extent in the Northeast, most recently in Hartford, Connecticut; Boston; and New York. In Hartford, prices rose 28 percent in 1987–88 before falling 21 percent over the next 4 years. Mortgages insured in 1987 in Hartford generally achieved a LTV of 80 percent sometime in 1988. Since then, however, the foreclosure rate of these loans has been running at more than three times the MI industry's overall foreclosure rate.

In all of these cases, the fallout of declining property values severely impacted regulated depository institutions in those regions, causing heavy outflows of capital and, in some cases, the foreclosure of some troubled institutions by regulators. The existence of private mortgage insurance helped to minimize the damage. From 1983 through 1987, the private mortgage insurance industry paid $4.6 billion in claims to policyholders (lenders and investors), seven-fold what was paid out by the industry in the prior 25 years. Clearly, the mortgage insurance industry's absorption of deep losses during this era points to the fact that it is indeed catastrophic coverage that protects the secondary mortgage markets and the free flow of funds into residential mortgages.

The impact of the falling property values presents a double whammy to lenders, investors, and insurers. Not only do falling values increase the depth of losses, but they typically lead to an increase in the incidence of loss. This phenomenon commonly occurs after rapid run-ups in property prices, making it perilous to automatically cancel MI coverage at the 80 percent LTV threshold exposing lenders and secondary market investors to deeper and more numerous losses.

2. *At origination, investors often require insurance on riskier loan types (such as investor loans and cash-out refinancings) with LTV's of 80 percent or less.* Since 1989, the foreclosure rate of insured mortgages with original LTV's of 80 percent or less has

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been greater than the foreclosure rate of all mortgages insured by the PMI industry.

**Q.4.** What percentage of PMI policies are for the life of the loan?

**A.4.** We aren't able to determine the number of policies that might run for the life of the loan, as that decision rightfully rests with the recipient of the insurance claim benefits, that being the lender or secondary market investor. However, based on the average term of coverage, the aging of the industry's insurance-in-force, and our knowledge of industry cancellation practices, the percentage of policies that run for the term of a loan would be significantly less than 1 percent.

The rationale behind our statement is as follows:

1. As mentioned earlier, the average term of coverage for a fixed-rate mortgage insured by MGIC is less than 4 years.
2. In the late 1970's and early 1980's, private mortgage insurers sold a limited number of policies which provided 100 percent claims coverage and that were required for the life of the loan. These policies were required for the life of the loan, as they provided the credit enhancement for the mortgage loans that served as collateral for mortgage revenue bonds. This practice no longer exists.
3. The bulk of the loans insured by the mortgage insurance industry are purchased by Fannie Mae and Freddie Mac, which dictate specific cancellation requirements to servicers, provided that the loan is current and is not in an area which is experiencing significant declines in property values. (These guidelines are attached.)
4. We are not aware of any lender or investor who requires borrower-paid mortgage insurance (BPMI) for the life of the loan.

**Q.5.** In testimony from the National Association of REALTORS®, R. Layne Morrill suggested that "the private mortgage insurer should be disclosed to the homebuyer at settlement, despite the fact that a mortgage insurer's client is the lender, not the homebuyer." Please comment on this suggestion.

**A.5.** Today, all lenders disclose to borrowers at settlement the existence of mortgage insurance and the terms of that coverage, including the length of coverage and the cost of such coverage. In addition, the HUD/Settlement Statement requires that the name of each person receiving a payment in connection with settlement, including a mortgage insurer, be disclosed to the homebuyer.

**Q.6.** The last few years have seen the increasing use of lender-paid mortgage insurance (LPMI). This relatively new product has not been scrutinized very closely by Federal regulators and raises a number of important questions. Should S. 318 be amended to address LPMI? If so, how? Are there adequate provisions in current law which mandate full disclosure of the costs and potential problems of LPMI?

What facts should the lender be required to disclose at closing in order to provide the consumer with an opportunity to make an informed choice on whether or not to accept LPMI? Should lenders be required to offer the consumer a choice between LPMI and the more traditional borrower-paid private mortgage insurance?

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What safeguards can be built into the law to ensure that lenders do not cancel mortgage insurance at some point and begin to reap the benefits of mortgage payments which are inflated due to the increased size of the mortgage?

What experience has your organization(s) had with LPMI? What conclusions were reached as a result of that experience?

**A.6.** With LPMI, the mortgage insurance is part of the borrower's interest rate, meaning that MI payments continue until the loan is paid off or refinanced. Because the mortgage insurance premium is part of the interest rate, there is no provision to cancel coverage, and as a result a borrower will pay for mortgage insurance for the term of the mortgage. To date, LPMI does not comprise a significant portion of the total mortgage insurance business.

MICA believes that all mortgage insurance should be treated equally under laws that Congress may pass. If the goal of congressional legislation is to supplement the current notification requirements, or otherwise guarantee that a borrower is notified of his rights, obligations, and the term of coverage of mortgage insurance, then lender-paid mortgage insurance should also be covered by this legislation.

At the present time, Fannie Mae has established guidelines covering LPMI. As this product matures and as borrowers, mortgage insurers, loan originators, and secondary marketing agencies experience the differences between LPMI and traditional borrower-paid insurance, we expect that the housing secondary market agencies will amend their guidelines accordingly.

## RESPONSE TO WRITTEN QUESTIONS OF SENATOR FAIRCLOTH FROM WILLIAM H. LACY

**Q.1.** What could be the potential effects of automatically canceling mortgage insurance on all mortgages which reach an 80 percent LTV ratio?

**A.1.** There is still a risk of default even for mortgages which have reached an 80 percent LTV. Private mortgage insurance companies continue to pay claims on mortgages which had reached an 80 percent LTV (in terms of the original purchase price of the house) at the time at which the mortgage defaulted. In these circumstances the proceeds from foreclosure did not cover the outstanding balance of the loan and payment from the private insurer was required by the investor, Fannie Mae and Freddie Mac, or the insured lender. Automatic cancellation once a loan has been paid down to 80 percent of the original purchase price of the house will result in investors, lenders, and secondary market agencies taking larger losses on those mortgages that default than would otherwise have been the case if private mortgage insurance had been maintained on the mortgage.

**Q.2.** What is your opinion of any automatic cancellation for mortgage insurance whether that number is at 80 percent LTV or at the half-life of a loan?

**A.2.** Both types of automatic cancellation of private mortgage insurance will require the lender, investor, or the secondary market agencies to assume more losses than would otherwise be the case. A policy of canceling insurance once the mortgage has been paid

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down or amortized to 80 percent of the original purchase poses greater risks to the lenders and investors in this regard than does cancellation at the half-life of the mortgage. This is because the original purchase price of the house may or may not be lower than the current value of the house and the mortgage insurance may be canceled even though the property value has fallen significantly. Moreover, the 80 percent LTV level may have been achieved over a relatively short period of time so that a long history of timely mortgage payments has not been achieved by the borrower. In contrast, a long-term history of consistent timely mortgage payments will be in evidence by the time the half-life of the mortgage loan has been attained.

**Q.3.** Does changing the current notification system and possibly adding automatic cancellation to the notification affect the cost of mortgage insurance?

**A.3.** The private mortgage insurer does not deal directly with the borrower in terms of notifying them as to the required payment for mortgage insurance or the terms of cancellation. This direct notification is done by the mortgage servicer or the lender. Consequently, the cost of mortgage insurance will not reflect any change in the costs of notification as these costs are assumed by the mortgage servicer or lender.

**Q.4.** Why are current provisions for mortgage insurance cancellation not working today?

**A.4.** As an industry the private mortgage insurers have no evidence that current provisions for mortgage insurance cancellation are not working. Every day private mortgage insurance companies receive cancellation requests from lenders which they immediately implement. The terms of private insurance master policies require that the insurance be canceled when the lender requests that it be canceled and the private insurer cannot deny cancellation. However, the legislative efforts of Congressman James Hansen and others reflect the need for additional consumer notification and the private mortgage insurance industry strongly supports those efforts. The private mortgage insurance industry believes that a well-informed homebuyer is the crucial part of the mortgage markets.

**Q.5.** What are some of the factors considered when determining cancellation in a mortgage insurance policy?

**A.5.** As noted above, the private mortgage insurer does not make the determination to cancel insurance coverage. That determination is made by the lender under terms of his agreement with the borrower. The most common factors which are considered when canceling mortgage insurance are found in the requirements set forth by Fannie Mae and Freddie Mac. These factors relate to the initial LTV of the loan, the payment history of the borrower, the appraised value of the property at the time at which cancellation is requested, the original value of the property, and the length of time the mortgage has been in existence. The secondary market agencies, however, have set their own requirements for how and when these factors allow the cancellation of private mortgage insurance coverage.

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## Chapter 1. Mortgage Insurance

Servicers are responsible for assuring that the mortgage insurance coverage we require when we purchase or securitize a mortgage remains in effect, by paying all renewal premiums promptly. However, there are some special situations that may affect the continuation of the mortgage insurance coverage.

### Section 101 FHA Mortgage Insurance

The servicer must keep in effect the FHA mortgage insurance that existed when we acquired the mortgage, unless the conditions we impose for cancelling or terminating the coverage are met.

The mortgage insurance premium for some FHA mortgages will have been paid in full (or financed in the mortgage) when the mortgage was originated. The premium for other FHA mortgages must be paid each year. When payment of an annual mortgage insurance premium is required, the servicer should use the funds in the mortgagor's escrow deposit account to pay the premium. If the deposit account balance is not sufficient to pay the mortgage insurance premium, the servicer should either get the necessary funds from the mortgagor or advance its own funds.

When a servicer agrees to the cancellation of FHA mortgage insurance (in accordance with Section 101.01 below), it must reduce the mortgagor's payment by any monthly escrow deposit that was being collected to pay the mortgage insurance premium. In addition, the servicer must advise the mortgagor of the amount of escrow funds that had accumulated for the payment of the next premium due—as well as the amount of any unearned premiums due from HUD. The mortgagor may then decide whether he or she wants a cash refund or credit toward an additional principal payment, a monthly payment, or an escrow account shortage.

### Section 101.01 Cancelling the Insurance

For mortgages held in our portfolio, the servicer must approve a mortgagor's written request to cancel the FHA mortgage insurance if the mortgagor has a satisfactory payment record—never more than 30 days delinquent in the 12-month period that precedes his or her request—and our interests will continue to be adequately protected. The servicer must not cancel FHA mortgage insurance for MBS pool mortgages.

Before agreeing to cancel the FHA mortgage insurance, the servicer must obtain—at the mortgagor's expense—a current appraisal of the property for retention in its permanent mortgage records. Then, if the property clearly meets the same standards that we would require for a property that secures a new conventional mortgage and the unpaid principal balance of the mortgage is not greater than 80% of the value of the property, the



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servicer must cancel the insurance. However, when the mortgage was closed as a refinance transaction, the servicer should not cancel the coverage unless the mortgagor has made 12 consecutive payments and has never been more than 30 days delinquent during that 12-month period.

To cancel the FHA mortgage insurance, the servicer should prepare and submit to HUD a ***Lender's Request for Termination of Home Mortgage Insurance*** (HUD Form 2344). The servicer does not need to notify Fannie Mae about the cancellation.

Section 101.02
Termination of
Coinsurance Period

FHA coinsured mortgages are automatically converted to full insurance when the 60th monthly payment is made, if the mortgage is current. The servicer does not have to notify us of this automatic change, but should contact us in cases in which the conversion is not automatic. For example, when a mortgage is under a special relief provision on the date the 60th monthly payment is scheduled to occur, the servicer should request HUD to convert it to full insurance if the mortgage is current under the terms of the relief provision. If HUD agrees to the conversion, the servicer should then notify us.

If the servicer cannot continue its coinsurance obligations because of its dissolution or bankruptcy, it should notify HUD and provide a list of all coinsured mortgages in its Fannie Mae portfolio. When HUD acknowledges that the mortgages will be converted to full insurance, the servicer should send us the list of mortgages and a copy of HUD's acknowledgment.

**Section 102**
**Conventional Mortgage Insurance**

The servicer must keep in effect the conventional mortgage insurance that existed when we acquired the mortgage, unless the conditions we impose for replacing or cancelling the coverage are met.

The mortgage insurance for conventional mortgages may have been paid for by the borrower or by the lender. The borrower may have paid for the mortgage insurance coverage by making a lump-sum payment at settlement to purchase life-of-the-mortgage coverage or by combining an initial payment at closing for the first year's premium with future annual premium payments to be paid from accumulated escrow deposits. Borrowers may also have paid for the mortgage insurance coverage by financing the premium in the mortgage amount or by agreeing to make monthly premium payments to the mortgage servicer. When the lender pays for the mortgage insurance coverage, it generally uses its own funds to pay the first year's premium at closing and agrees to pay annual renewal premiums for each subsequent year of coverage. (In a few cases, the lender may pay a lump-sum life-of-the-mortgage premium at closing.)



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When the payment of an annual renewal premium is required for conventional mortgages that have borrower-purchased mortgage insurance, the servicer should use the funds in the mortgagor's escrow deposit account to pay the mortgage insurance premium. If the deposit account balance is not sufficient to pay the premium, the servicer should either get the necessary funds from the mortgagor or advance its own funds. On the other hand, when the mortgage insurance policy requires monthly premium payments, the servicer should collect the premium amount from the borrower as part of his or her regular mortgage payment. If the borrower fails to make a monthly payment (or does not include the mortgage insurance premium amount with a payment), the servicer must advance its own funds to keep the mortgage insurance coverage in force (and then subsequently collect the funds from the borrower).

Payment of the renewal premium for lender-purchased mortgage insurance for conventional mortgages is the servicer's corporate responsibility. As such, the premium must be paid from the servicer's own funds (which may be obtained from any source)—even if the borrower does not make his or her mortgage payments. We strongly encourage servicers to set aside monies for the payment of these renewal premiums each month so that they will have accumulated the full premium amount by its due date. (These monies may be kept in one of the servicer's internal operating accounts or in a specially designated account. Servicers may not deposit these funds in a Fannie Mae custodial account unless we authorize the use of a separate custodial account that is designed solely for this purpose.)

Normally, when borrower-purchased conventional mortgage insurance coverage is cancelled (in accordance with Section 102.02 below), the servicer must reduce the mortgagor's payment by any monthly escrow deposit that was being collected to pay the mortgage insurance premium. In addition, the servicer must advise the mortgagor of the amount of escrow funds that had accumulated for the payment of the next premium due—as well as the amount of any unearned premiums due from the MI. The mortgagor may then decide whether he or she wants a cash refund or credit toward an additional principal payment, a monthly payment, or any escrow account shortage. However, if the mortgage insurance premium was included in the amount financed, the servicer must *not* reduce the mortgagor's monthly payment. In such cases, the servicer must return any unearned mortgage insurance premium it receives from the MI directly to the mortgagor.

**Section 102.01**
**Replacement Policies**

At any time, the original mortgage insurance policy can be replaced by a policy from another acceptable mortgage insurer that provides generally equivalent mortgage insurance coverage. (A listing of acceptable mortgage



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insurers appears in Exhibit 1 at the end of this Chapter.) Two situations in which the coverage would be replaced are when the property is sold and when the rehabilitation work is completed for a mortgage we purchased before the completion of certain renovations or home improvements.

If we are holding the previous original policy or certificate and the mortgage insurer requires the original insurance policy or certificate to be returned, the servicer should submit a *Custody Document Transmittal* (Form 276) to our document delivery facility to request the release of the original insurance policy or certificate.

## Section 102.02 Cancelling the Insurance

The servicer must keep ***lender-purchased*** mortgage insurance coverage for conventional mortgages in effect until the mortgage is paid-in-full. The servicer may retain any premium refund it receives in connection with a policy cancellation that results from a payoff of the mortgage debt.

We generally use two different methods for determining whether ***borrower-purchased*** mortgage insurance coverage for conventional mortgages can be cancelled—one is based on the ***original*** value of the property and the other is based on the ***current*** appraised value of the property. However, if the mortgage was part of a negotiated transaction, we may have specified other conditions for cancelling the mortgage insurance coverage. When that is the case, the terms of the negotiated contract apply.

**A. Cancellation based on original value.** When borrower-purchased mortgage insurance coverage is cancelled based on the original value of the property, the cancellation may result from the servicer's use of procedures that provide for automatic cancellation under certain conditions or from the mortgagor's request to have the coverage cancelled.

- Servicers ***may automatically*** cancel borrower-purchased mortgage insurance coverage for a current ***first*** mortgage when the unpaid principal balance of the mortgage has been paid down to 80% of the ***original*** value of the property, unless the servicer thinks that the property may have depreciated in value since the original appraisal. For ***second*** mortgages, the servicer must base its automatic cancellation on the combined principal balances for both the first and second mortgages having been paid down to 70% of the value of the property at the time we purchased or securitized the second mortgage.

- Servicers generally ***must*** cancel borrower-purchased mortgage insurance coverage for a current mortgage if the mortgagor requests that it be cancelled and the unpaid principal balance of a first mortgage has been paid down to 80% of the ***original*** value of the property (or, if the



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mortgage is a second mortgage, the combined principal balance of both the first and second mortgages having been paid down to 70% of the value of the property at the time we purchased or securitized the second mortgage). However, when the mortgage was closed as a refinance transaction, the servicer should not cancel the coverage unless the mortgagor has made 12 consecutive payments and has never been more than 30 days delinquent during that 12-month period. In addition, if the servicer believes that it is necessary to assure that the property has retained its value, the servicer may require the mortgagor to submit a current appraisal for the property before it cancels the coverage.

**B. Cancellation based on current appraised value.** When borrower-purchased mortgage insurance is cancelled based on the current appraised value of the property, the servicer must approve the mortgagor's request to cancel the conventional mortgage insurance for a current *first* mortgage if he or she has a satisfactory payment record—never more than 30 days delinquent in the 12-month period that precedes his or her request—and obtains a new appraisal that indicates that the mortgage balance is below 80% of the *current* appraised value of the property. For *second* mortgages, the combined principal balances of the first and second mortgages must be below 70% of the current appraised value of the property. The new appraisal should be made a part of the permanent mortgage records.



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# Servicing

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## Exhibit 1 Acceptable Mortgage Insurers

| MI | MI Code |
|---|---|
| • Alaska Housing Finance Corporation[1] (only special financing of former TMIC-insured mortgages) | 25 |
| • Amerin Guaranty Corporation | 33 |
| • California Housing Insurance Fund (only California first mortgages) | 31 |
| • CMG Mortgage Insurance Company | 38 |
| • Commonwealth Mortgage Assurance Company | 17 |
| • Foremost Mortgage Insurance Company | 09 |
| • General Electric Mortgage Insurance Companies | 01 |
| • Home Guaranty Insurance Corporation[3] | 16 |
| • Integon Mortgage Guaranty Corporation[1] | 20 |
| • Investors Mortgage Insurance Company[2] | 05 |
| • Maryland Housing Fund (only Maryland first mortgages) | 14 |
| • Mortgage Guaranty Insurance Corporation | 06 |
| • New York City Residential Mortgage Insurance Corporation (only New York City first mortgages) | 30 |
| • Old Republic Insurance Company (only HomeStyle second mortgages) | 34 |
| • PMI Mortgage Insurance Company | 11 |
| • Policyholders Benefit Corporation[1] (only former TMIC-insured mortgages) | 27 |
| • Puerto Rico Housing Bank and Finance Agency (only Puerto Rico first mortgages) | 36 |



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# Servicing

**Exhibit 1 Acceptable Mortgage Insurers (cont . . .)**

| | |
|---|---|
| • Republic Mortgage Insurance Company | 13 |
| • Triad Guaranty Insurance Company | 24 |
| • United Guaranty Credit Insurance Company (only HomeStyle second mortgages) | 35 |
| • United Guaranty Residential Insurance Corporation | 12 |
| • U.S. Mortgage Insurance Company[1] | 19 |
| • Verex Assurance, Incorporated[1] | 02 |
| • Vermont Home Mortgage Guaranty Board (only Vermont fixed-rate first mortgages and STABLE home mortgages originated as ARM Plan 1104, which have loan-to-value ratios of 90% or less) | 22 |
| • Wisconsin Mortgage Assurance Corporation[1] | 07 |

[1]May be used for renewals of existing policies only.

[2]May be used to continue coverage only for mortgages that were more than 60 days delinquent as of 9/20/91.

[3]This company will no longer be issuing mortgage insurance policies. Any existing policies that were not transferred to Verex Assurance, Incorporated (VEREX) will be 100% reinsured by VEREX.





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# Chapter 61

## Mortgage Insurance

### 61.1

**Mortgage insurance warranties**

The Servicer warrants that mortgage insurance is maintained as required in Section 27.1 unless canceled in accordance with the requirements of Sections 61.2 and 61.3. The Servicer also warrants that the Borrower has been given all disclosures required by law relating to the terms on which the mortgage insurance may be canceled.

### 61.2

**Mortgage insurance cancelation**

The Servicer must review requests for cancelation of mortgage insurance in accordance with the requirements of Sections 61.2(a)–61.2(f).

**(a) Borrower or transferee eligibility**
The Borrower, or a transferee of the Borrower approved in accordance with the provisions of Chapter 60, must submit a written request for cancelation of mortgage insurance to the Servicer. If the conditions of this section are met, the Servicer must cancel mortgage insurance.

LTV

**(b) LTV ratio**
The loan-to-value (LTV) ratio may be no higher than one of the ratios stated in the following chart, and the required condition corresponding to the LTV ratio must be met:



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61.2
Mortgage insurance cancelation (continued)

| Option | LTV ratio (Owner-Occupant or second home) | LTV ratio (Investment property) | Basis or method of determining value |
|---|---|---|---|
| 1 | 80% | 65% | Current appraised value |
| | **Required condition:** Two years have elapsed since the Origination Date of the Mortgage and the Mortgaged Premises have been improved* **or** Five years have elapsed since the Origination Date of the Mortgage | | |
| 2 | 80% | 65% | Original value (the lesser of the original purchase price or the original appraised value) |
| | **Required condition:** Two years have elapsed since the Origination Date of the Mortgage, the 80% LTV ratio has been reached as a result of payments on principal (scheduled payments or prepayments), and the Servicer represents that the current value of the Mortgaged Premises is at least equal to their original value** | | |
| 3 | 75% | 60% | Current appraised value |
| | **Required condition:** Two or more years but less than five years have elapsed since the Origination Date of the Mortgage | | |

*The improvements requirement of option 1 is satisfied only if the increase in value of the Mortgaged Premises is directly attributable to improvements to the Mortgaged Premises that were made after the Origination Date of the Mortgage and that conform to local zoning and building codes.

**Option 2 may be selected only if the Servicer represents that the current value of the Mortgaged Premises is at least equal to the original value (the lesser of the original appraised value or the original purchase price). To make this representation, the Servicer may choose either



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**61.2 Mortgage insurance cancelation (continued)**

- To warrant that, as of the date on which the mortgage insurance is canceled, the value of the Mortgaged Premises is at least equal to the original value, or
- To obtain a certification of the value of the Mortgaged Premises that is prepared within 60 days of the date on which the written request for mortgage insurance cancelation is received by the Servicer. This certification may include, but is not limited to,
  - A recertification of market value by a Servicer-approved appraiser other than the original appraiser, or
  - A certified analysis of the current market value prepared by a real estate brokerage company that is licensed to do business as a real estate broker in the jurisdiction where the Mortgaged Premises are located, or
  - A new appraisal prepared by a Servicer-approved appraiser other than the original appraiser

For purposes of this section, current appraised value is the estimated market value of the Mortgaged Premises that is

- Determined within 60 days of the date on which the written request for cancelation of mortgage insurance is received by the Servicer
- Determined by an appraiser approved by the Servicer who did not also prepare the original appraisal
- Prepared by the appraiser on the applicable Freddie Mac appraisal form in accordance with current Freddie Mac appraisal requirements and guidelines for owner-occupied properties, second homes or investment properties, as applicable

When any increase in the current appraised value of the Mortgaged Premises is attributed to property improvements made after the Origination Date of the Mortgage, the appraiser must certify estimates of both the value of the improvements made and the value added to the Mortgaged Premises by the improvements.

(c) **Payment record**
With respect to the monthly payments of principal, interest and Escrow, the Borrower (or the approved transferee)



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**61.2**
**Mortgage insurance cancelation (continued)**

- May not have been delinquent 16-29 days more than one time during the 12-month period immediately preceding the date on which the written request for mortgage insurance cancelation is received by the Servicer
- May not have been delinquent 30-59 days more than one time during the 12-month period immediately preceding the above period

(d) **Other defaults**
There may not have been any other default under the terms of the Security Instrument at any time during the 12-month period immediately preceding the date on which the Servicer receives the written request for mortgage insurance cancelation.

| ARM |
|---|
| GPM |

(e) **ARM or GPM**
If the Mortgage is an adjustable-rate Mortgage (ARM) or a graduated-payment Mortgage (GPM), at least 12 months must have elapsed since the date of the most recent increase in the amount of the monthly installment of principal and interest payable by the Borrower (or the approved transferee).

(f) **Occupancy**
When a Borrower (or an approved transferee) requests that mortgage insurance be canceled, the occupancy of the Mortgaged Premises as of the date on which the Servicer receives the written request for cancelation governs whether the cancelation requirements for owner-occupied/second home or investment property must be met.

## 61.3

**Special provisions for cancelation**

The fee for any applicable appraisal, recertification or analysis of current market value may be charged to the Borrower (or the approved transferee).

When the premium for mortgage insurance is included in the original loan amount and the insurance is canceled in accordance with Section 61.2 or as a result of a full prepayment of the related Mortgage, the Servicer must remit to the Borrower any premium amount refunded by the MI to the Servicer.



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## 61.4

### Adjustment for and notice of cancelation

Upon cancelation of mortgage insurance, the Service must

- Discontinue the collection of related premiums
- Make any necessary adjustment to the Borrower's Escrow account and the Escrow portion of the monthly installment amount
- Advise the Borrower, in writing, of all such adjustments

## 61.5

### FHA Mortgages

FHA insurance must not be canceled while Freddie Mac has an ownership interest in the Mortgage.



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## RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO FROM RON McCORD

**Q.1.** What are the average monthly PMI payments?

**A.1.** At American Mortgage and Investment Company, the average monthly PMI payment is $27.95. The average monthly payment will vary for each lender depending on the average loan balance, the level of insurance coverage, and the amount of the loan.

**Q.2.** What is the duration of an average PMI policy? How long do most consumers actually make PMI payments?

**A.2.** Lenders are not in the best position to determine the average length of a PMI policy or the average length of time borrowers actually make PMI payments. However, the average life span of a mortgage is 7 years, and PMI is usually required until the loan is paid in full. On average, every 7 years, borrowers either refinance or move and secure another mortgage. Thus, it can be assumed that the average length of a PMI policy is approximately 7 years, with borrowers making payments during that time.

**Q.2.a.** Please estimate what percentage of homeowners request cancellation of their policies when they reach the determined equity level. How common is it for homeowners to cancel PMI before the 80 percent loan-to-value ratio is reached by having a new appraisal done or by other means?

**A.2.a.** Approximately 5 percent of homeowners at American Mortgage and Investment Co. request cancellation of PMI, and only .5 percent of homeowners cancel PMI prior to attaining the 80 percent loan-to-value ratio, either by virtue of a new appraisal or by other means.

**Q.3.** What is the risk of default on a mortgage loan which has a loan-to-value ratio of 80 percent or less?

**A.3.** Unfortunately, neither American Mortgage and Investment Co. nor the Mortgage Bankers Association has data compiled which would determine the risk of default on these types of mortgages. However, we assume that the default rate is quite low since a homeowner with 20 percent equity would be better off selling the house than defaulting on the mortgage.

**Q.4.** What percentage of PMI policies are for the life of the loan?

**A.4.** Most PMI policies are written for the life of the loan.

**Q.5.** In testimony from the National Association of REALTORS®, R. Layne Morrill suggested that "the private mortgage insurer should be disclosed to the homebuyer at settlement, despite the fact that a mortgage insurer's client is the lender, not the homebuyer." Please comment on this suggestion.

**A.5.** Disclosure of the private mortgage insurer (MI) to the borrower is inconsequential and unnecessary. Typically, the borrower has no need to contact the MI and, thus, disclosure of the MI does not provide any additional value to the borrower. In fact, the only time a borrower usually has contact with a MI is in the case of default. In such instances, the MI generally works in coordination with the servicer and the borrower for a possible workout of the existing mortgage payment structure. In addition, it is often impossible for the lender to disclose the MI at settlement. Lenders have

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relationships with multiple MI's. Depending upon the level of authority that a lender is granted, whether it be full authority or delegated authority, the MI may not be assigned to a mortgage until sometime after closing. Therefore, it may not be possible to disclose the MI company to the borrower at settlement.

**Q.6.** The last few years have seen the increasing use of lender-paid mortgage insurance (LPMI). This relatively new product has not been scrutinized very closely by Federal regulators and raises a number of important questions. Should S. 318 be amended to address LPMI? If so, how? Are there adequate provisions in current law which mandate full disclosure of the costs and potential problems of LPMI?

**A.6.** S. 318 should not be amended to address LPMI. LPMI is structured in such a way that the benefit of cancellation could not be passed on to the borrower. If LPMI were to be canceled, the terms of the note and the mortgage deed of trust would have to be rewritten. The costs of modifying and re-recording the security instruments would ultimately be borne by borrowers. Thus, the perceived value would be outweighed by the cost to the borrower. Apparently, current law does not address LPMI.

**Q.6.a.** What facts should the lender be required to disclose at closing in order to provide the consumer with an opportunity to make an informed choice on whether or not to accept LPMI? Should lenders be required to offer the consumer a choice between LPMI and the more traditional borrower-paid private mortgage insurance?

**A.6.a.** The lender should not be mandated to disclose the choices regarding PMI to the borrower at closing. Currently, the industry is providing for such disclosures in advance of closing. Borrowers are given options and are fully aware of the advantages and disadvantages when they make their insurance choices. These decisions are made well in advance of settlement. Therefore, additional regulation is not warranted, nor is it necessary.

**Q.6.b.** What safeguards can be built into the law to ensure that lenders do not cancel mortgage insurance at some point and begin to reap the benefits of mortgage payments which are inflated due to the increased size of the mortgage?

**A.6.b.** If I understand the question properly, it is highly unlikely that a situation like this would occur. Investor guidelines and bank regulations prohibit a lender from canceling insurance arbitrarily, and any prudent lender would keep the insurance in force in order to offset the risk of default to third parties. Thus, it is difficult to imagine that a lender/servicer would cancel LPMI with the insurer and continue to collect the premiums. It is too risky.

**Q.6.c.** What experience has your organization(s) had with LPMI? What conclusions were reached as a result of that experience?

**A.6.c.** American Mortgage and Investment Co. has very little experience with LPMI. According to *Inside Mortgage Finance* [*Feb. 7, 1997; Issue 1997:6*], LPMI had a market share of only 6 percent in 1996. Due to my inexperience and the insignificant market share of the product, no conclusions can be reached at this time.

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**RESPONSE TO WRITTEN QUESTIONS OF SENATOR FAIRCLOTH FROM RON McCORD**

**Q.1.** It is understood that PMI is typically required by the lender when a downpayment on a home is less than 20 percent of the purchase price. Are there ever occasions where, because of risks, a lender may wish to have private mortgage insurance coverage on a loan even if the borrower starts with a LTV under 80 percent? If the answer is yes, please give an example and reasons why.

**A.1.** Yes, there are occasions when a lender/investor may require PMI even though a borrower's LTV is under 80 percent. These occasions typically materialize when there are irregularities in a borrower's credit history and/or when a borrower has a poor payment performance, especially in relation to a previous mortgage.

**Q.2.** Is there ever the need to maintain PMI for the life of any single-family residential loan?

**A.2.** Yes, it is possible that PMI may need to be maintained for the life of a loan. PMI for the life of the loan is usually warranted when a loan is considered inherently risky. Loans which may pose a heightened risk include adjustable rate mortgages (ARM's) and condominium/cooperative loans.

**Q.3.** At what point after closing could the homebuyer be notified of the conditions and terms of the investor's cancellation policy?

**A.3.** On an annual basis, servicers can provide disclosures that indicate PMI may be able to be canceled. Specific investor guidelines could be made available upon request by the borrower.

**Q.4.** What is your opinion of having automatic cancellation at the half-life of a loan and before that time having cancellation upon the investor's guidelines?

**A.4.** We have no problem with mandating automatic cancellation at the half-life of a loan as well as cancellation prior to half-life based upon the investor's guidelines. The half-life is easily ascertained by servicers, and lenders now already review borrowers' requests for cancellation of PMI using investor guidelines. Thus, the proposed scheme is not difficult for servicers to administer.

**Q.5.** Who has up-to-the-minute data concerning the outstanding unpaid balance on a mortgage?

**A.5.** The servicer has the latest data on the outstanding unpaid principal balance.

**Q.6.** Why are current provisions for mortgage insurance cancellation not working today?

**A.6.** From the servicer perspective, the current procedures for cancellation of PMI are effective. As you already know, the procedures for cancellation are based on investor guidelines. Therefore, if the guidelines are followed, PMI is canceled. There is a problem, however, in the way some borrowers have been treated when attempting to cancel PMI. This unfair treatment coupled with life of the loan contracts, the lack of information regarding the cancellation of PMI, the cost of complying with some of the investor requirements (e.g. appraisals), and the desire for automatic termination have contributed to the belief that PMI cancellation does not work. For servicers, however, the process has not been a problem.

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## RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO FROM FRANK J. SUTKOWSKI

**Q.1.** What are the average monthly PMI payments?

**A.1.** Based on information requested from a sampling of ACB's membership and other data available, an estimate of the average PMI payment would be approximately $50 per month.

**Q.2.** What is the duration of an average PMI policy? How long do most consumers actually make PMI payments? Please estimate what percentage of homeowners request cancellation of their policies when they reach the determined equity level. How common is it for homeowners to cancel PMI before the 80 percent loan-to-value ratio is reached by having a new appraisal done or by other means?

**A.2.** Based on information requested from a sampling of ACB's membership and other data available, a quick estimate of the average duration of PMI policies and the period under which consumers make PMI payments would be approximately 54 months.

According to information provided to us by our members, the percentage of homeowners that request cancellation of their PMI when they have reached an appropriate LTV ratio varies greatly according to locality. Areas that tend to have high loan-to-value ratios and PMI coverage also tend to have a significant portion of the loans that are FHA-insured. This raises the issue that Congress should also review FHA insurance termination options at some point because these borrowers are often low-income and would generally welcome the relief. Those areas with higher concentrations of mortgage insurance of either the FHA or PMI type coverage also have a lower cancellation request rate because of the different standards applicable to FHA loans. Areas that have a greater number of lower loan-to-value ratios have a greater percentage of homeowners that, if covered by PMI, request information for cancellation at the appropriate time, early in the loan life.

The frequency of homeowner requests for PMI cancellation based on appreciation of the property's value also varies greatly depending on locality. Areas that are experiencing more favorable real estate markets tend to have more frequent requests based on current appreciated values, while areas that are experiencing less favorable economic real estate conditions have far fewer requests. It is not possible to make a truly valid generalization as to the frequency of PMI cancellation requests based on property appreciation from recent experience since so many loans refinanced in the 1993 to 1995 period because of interest rate declines. Many refinances were accompanied by the dropping of PMI, but these cases were not recorded separately. It is clear, however, that PMI requests based on original purchase price are the least frequently received type.

**Q.3.** What is the risk of default on a mortgage loan which has a loan-to-value ratio of 80 percent or less?

**A.3.** Generally, there is a relatively lower risk of default on mortgage loans with current LTV ratios of 80 percent or less. More often than not, when a home with a LTV of 80 percent or less nears possible default, the owner can and will sell the home without significant risk of any additional losses to the lender. However,

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loans that have a LTV of 80 percent or less based on the original sales price of the property, but are in areas that have or are experiencing market declines or that have experienced property damage, can pose a greater risk of loss to the lender. In these situations the actual value of the property may be quite a bit less than the sales price, and the costs which are associated with selling the home may be greater than the current equity in the home. Defaults under these circumstances, while still not common, do occur to a limited extent in most areas.

**Q.4.** What percentage of PMI policies are for the life of the loan?

**A.4.** Based upon a sampling of our membership, ACB did not find any lenders requiring PMI coverage for the future life of regular non-FHA/VA type loans. While PMI policies may stay in effect until canceled, most of ACB's members make borrowers aware of their PMI policies at settlement and beyond, routinely allowing policies to be canceled at an appropriate time upon the borrower's request.

**Q.5.** In testimony from the National Association of REALTORS®, R. Layne Morrill suggested that "the private mortgage insurer should be disclosed to the homebuyer at settlement, despite the fact that a mortgage insurer's client is the lender, not the homebuyer." Please comment on this suggestion.

**A.5.** The vast majority of our members already disclose the name of the private mortgage insurer to borrowers at the time of settlement. ACB would be willing to see this as a regular disclosure requirement. ACB would also suggest that the ultimate beneficiary of the insurance is the borrower (because of the borrowers role in credit availability), no matter who the PMI company's "client" is as a legal matter.

**Q.6.** The last few years have seen the increasing use of lender-paid mortgage insurance (LPMI). This relatively new product has not been scrutinized very closely by Federal regulators and raises a number of important questions. Should S. 318 be amended to address LPMI? If so, how? Are there adequate provisions in current law which mandate full disclosure of the costs and potential problems of LPMI?

What facts should the lender be required to disclose at closing in order to provide the consumer with an opportunity to make an informed choice on whether or not to accept LPMI? Should lenders be required to offer the consumer a choice between LPMI and the more traditional borrower-paid private mortgage insurance?

What safeguards can be built into the law to ensure that lenders do not cancel mortgage insurance at some point and begin to reap the benefits of mortgage payments which are inflated due to the increased size of the mortgage?

What experience has your organization(s) had with LPMI? What conclusions were reached as a result of that experience?

**A.6.** LPMI should be excluded from the coverage of S. 318 because it is applied in a significantly different manner than the traditional PMI. LPMI is a specialized product that benefits borrowers who desire to have a lower premium payment monthly (over separate PMI payments) and/or who can take advantage of the tax benefits that

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are associated with folding mortgage insurance into the mortgage note within the interest rate.

Generally, lenders who offer LPMI explain its benefits versus the benefits of PMI and what the inclusion of the LPMI payments in the loan note means, (i.e., lower monthly mortgage insurance cost, slightly increased mortgage payments over the life of the loan, and tax deductibility of payments as an added interest cost). The choice between traditional PMI and LPMI provides borrowers with the option of having the tax benefits associated with LPMI or the cancellation features of the traditional PMI. To terminate or alter the mortgage insurance payments, which are in the form of interest payments on the mortgage, the borrower on these mortgage loans would have to refinance. Because of the "form over substance" doctrine within the tax code, control by the borrower of that interest rate margin used for LPMI would be inconsistent with the tax deductibility of that part of the coupon interest rate. In the case of traditional PMI, the payments are made separately and cancellation does not effect the note. The different termination structures are part of the trade-off decision that the customer has to make.

If both PMI and LPMI are available and the lender offers both mortgage insurance types, borrowers should have the opportunity to choose which option best fulfills their particular circumstances. ACB's members explain these options to their customers. Disclosure of this type is completely appropriate.

It would be impossible to build provisions into the law regarding lender retention of LPMI over the life of the loan. Lender benefit from LPMI is generally limited to the slightly increased interest rate on the loan that reflects the cost of the insurance product. While the lender may derive some added benefit from the continued mortgage payments by the borrower if the insurance has been canceled, the borrower also continues to receive the tax benefits associated with the deductibility of the mortgage interest. In addition, because the "cost" of the mortgage insurance has been spread over the life of the loan in the form of the interest payments, the borrower is paying for a product received, in much the same way someone purchases a product on an installment basis.

The LPMI option, because of the tax deductibility feature and the potential lower monthly payment compared to traditional PMI, is very attractive to many homeowners and is proving to be a viable alternative to traditional PMI. As a result, it is a useful "niche" product for well-informed customers. Because of the need to have the PMI payment totally built into the coupon interest rate on the loan to ensure tax deductibility for the borrower, careful up-front disclosure is the best solution to the problem of ensuring an optimal decision by each borrower.

## RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO FROM BRIAN L. McDONNELL

**Q.1.** What are the average monthly PMI payments?

**A.1.** Navy Federal's average conventional loan amount is currently $119,000. I have provided examples of the monthly PMI premiums for this loan amount at the various loan-to-value ratios and the average monthly premiums for loan amounts of $75,000, $100,000,

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$150,000, and $200,000. The table below shows the effect of loan-to-value and loan size on the monthly cost of PMI.

**Typical PMI Monthly Premiums**
*(30-Year Fixed-Rate Mortgages)*

| Loan Amount | Loan-to-Value | | | |
|---|---|---|---|---|
| | 97% | 95% | 90% | 85% |
| $ 75,000 | $ 65.00 | $ 48.75 | $ 32.50 | $ 20.00 |
| $100,000 | $ 86.67 | $ 65.00 | $ 43.33 | $ 26.67 |
| $119,000 Navy Federal Average | $103.13 | $ 77.35 | $ 51.56 | $ 31.74 |
| $150,000 | $130.00 | $ 97.50 | $ 65.00 | $ 40.00 |
| $200,000 | $173.34 | $130.00 | $ 86.67 | $ 53.34 |

Overall, the average monthly PMI premium paid by a Navy Federal member is $48.73.

**Q.2.** What is the duration of an average PMI policy? How long do most consumers actually make PMI payments? Please estimate what percentage of homeowners request cancellation of their policies when they reach the determined equity level. How common is it for homeowners to cancel PMI before the 80 percent loan-to-value ratio is reached by having a new appraisal done or by other means?

**A.2.** Navy Federal automatically cancels PMI when the loan balance is reduced to 80 percent of the original property value (or the loan-to-value specified by the secondary market investor who purchased the loan). At current interest rates, the balance on a 90 percent loan will be reduced to 80 percent in approximately 9 years with normal amortization. A 95 percent loan will require 11 years to reduce the balance to 80 percent with normal amortization. As interest rates have declined in the past several years, many Navy Federal loans with PMI have refinanced prior to the loan balance being reduced to 80 percent.

Currently, Navy Federal receives approximately 30 inquiries per month from members who ask about PMI cancellation procedures, although their loan balances have not been reduced to the 80 percent level. We explain very carefully that the PMI is required until the loan balance reaches 80 percent loan-to-value and that, currently, their balance is higher than the required amount.

We also explain that if they feel the value of their property has increased through appreciation or improvements made, a new appraisal can be obtained, using a Navy Federal-approved appraiser. The cost of an appraisal averages $350, and this expense is borne by the member. If the appraised value is 80 percent or less and the loan meets secondary market investor requirements for payment history, we will cancel the PMI. At present, of the average 30 calls

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received per month, approximately 10 (33 percent) of the members choose to order an appraisal.

Many of our members also remit additional principal payments to reach the 80 percent loan-to-value ratio and cancel the PMI.

**Q.3.** What is the risk of default on a mortgage loan which has a loan-to-value ratio of 80 percent or less?

**A.3.** Although loan-to-value is only one variable which determines the risk of default, Navy Federal's PMI loans are almost twice as likely to be 30 days or more delinquent when compared to uninsured loans.

| 30 Days or More Delinquent Conventional Loans | |
|---|---|
| Uninsured | .82% |
| Insured | 1.51% |

Navy Federal's PMI loans are three times more likely to be 90 days past due than uninsured loans.

| 90 Days or More Delinquent Conventional Loans | |
|---|---|
| Uninsured | .08% |
| Insured | .29% |

Insured conventional loans make up only about 13 percent of Navy Federal's conventional loan portfolio, but they account for 21.3 percent of our total conventional loan delinquency.

**Q.4.** What percentage of PMI policies are for the life of the loan?

**A.4.** None of Navy Federal's conventional mortgage loans require PMI coverage for the life of the loan.

**Q.5.** In testimony from the National Association of REALTORS®, R. Layne Morrill suggested that "the private mortgage insurer should be disclosed to the homebuyer at settlement, despite the fact that a mortgage insurer's client is the lender, not the homebuyer." Please comment on this suggestion.

**A.5.** At the time of settlement, the private mortgage insurer has been selected by the lender and, therefore, the name could easily be disclosed to the borrower. While Navy Federal has no objection to disclosing the name of the mortgage insurer to our members, we are not aware of any specific benefit to the member to have this information. The lender chooses the mortgage insurer to underwrite and insure the loan—not the borrower. PMI premium rates charged by mortgage insurers are the same nationwide; therefore, there is no opportunity for consumers to shop for lower premiums.

**Q.6.** The last few years have seen the increasing use of lender-paid mortgage insurance (LPMI). This relatively new product has not

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been scrutinized very closely by Federal regulators and raises a number of important questions. Should S. 318 be amended to address LPMI? If so, how? Are there adequate provisions in current law which mandate full disclosure of the costs and potential problems of LPMI?

What facts should the lender be required to disclose at closing in order to provide the consumer with an opportunity to make an informed choice on whether or not to accept LPMI? Should lenders be required to offer the consumer a choice between LPMI and the more traditional borrower-paid private mortgage insurance?

What safeguards can be built into the law to ensure that lenders do not cancel mortgage insurance at some point and begin to reap the benefits of mortgage payments which are inflated due to the increased size of the mortgage?

What experience has your organization(s) had with LPMI? What conclusions were reached as a result of that experience?

**A.6.** Navy Federal evaluated LPMI several years ago and decided it was not a type of mortgage insurance that was beneficial to our membership. Our members would have to pay a higher interest rate for a loan-to-value ratio in excess of 80 percent and forego the opportunity to cancel the insurance coverage at a later date. We were uncomfortable with our members not having the opportunity to cancel LPMI while paying a higher interest rate and we decided against offering it.

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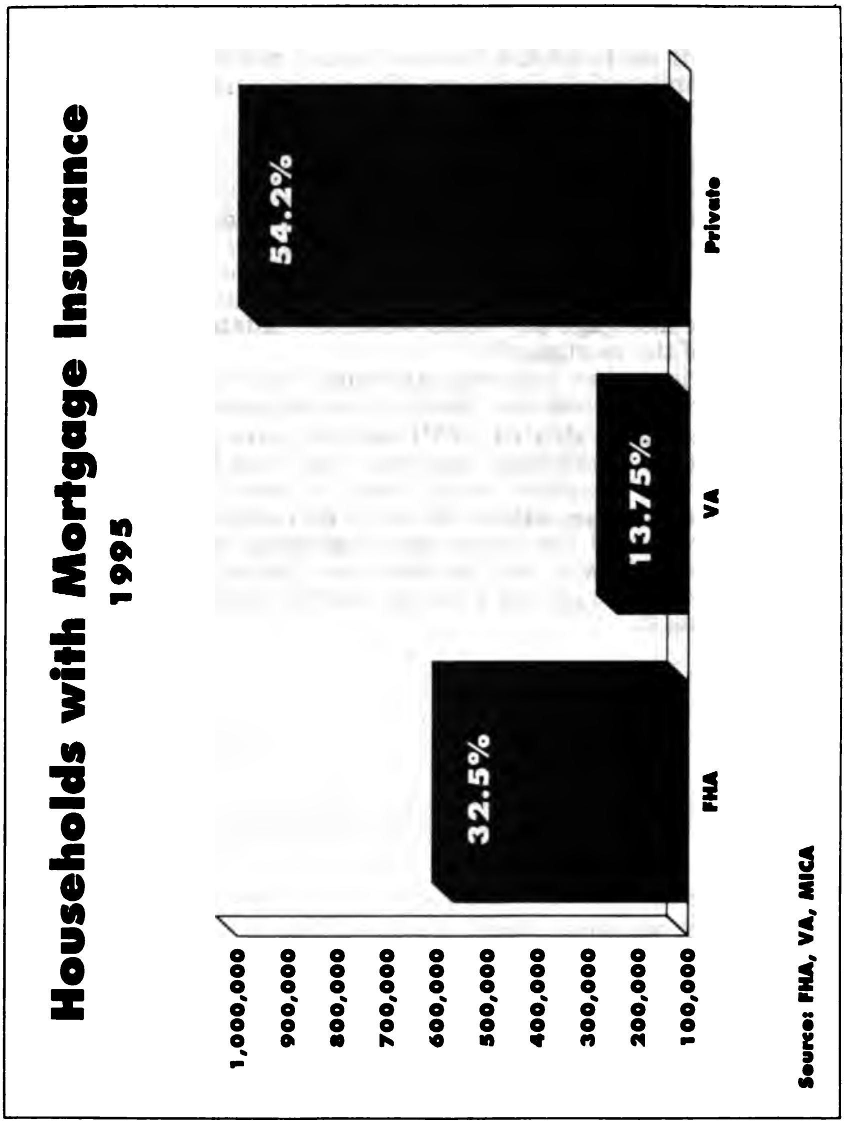

Households with Mortgage Insurance
1995
1,000,000
900,000
800,000
700,000
600,000
500,000
400,000
300,000
200,000
100,000
32.5%
13.75%
54.2%
FHA
VA
Private
Source: FHA, VA, MICA

THE NATION'S HOUSING

Washington Post - February 22, Saturday E1

# Legislation Targets Overcharges On Private Mortgage Insurance

By Kenneth R. Harney

If you have private mortgage insurance, you could be on the verge of getting important new federal consumer protections designed to prevent you from being hit with abusive overcharges on premiums.

In rapid succession last week, legislators in the Senate and House introduced bills that would force all lenders for the first time to disclose to borrowers how and when they can cancel their mortgage insurance coverage. One bill, the Homeowners Protection Act of 1997, would go even further: It would require that private mortgage insurance be terminated automatically whenever the borrower's loan balance is equal to or less than 80 percent of the value of the home at the time the loan was closed.

Sponsored by Senate Banking Committee Chairman Alfonse M. D'Amato (R-N.Y.), the bill would outlaw a widespread industry practice: collection of mortgage insurance premiums long beyond the point necessary to protect the lender or owner of the mortgage from the possibility of financial loss from default or foreclosure.

"This is a practice of fleecing homeowners which must be stopped," D'Amato said in introducing his bill. "Consumers are unknowingly paying anywhere from $240 to $1,200 a year for absolutely no reason."

D'Amato's bill, scheduled for Banking Committee hearings later this month, is the Senate companion to a House bill sponsored by Rep. James V. Hansen (R-Utah). Hansen pushed his bill during the last Congress, but never attracted much support. This year, with increased media attention to overcharges in private mortgage insurance, he has attracted bipartisan backing, including liberal Democrats like Rep. Joseph P. Kennedy II (D-Mass.).

Private mortgage insurance, known as PMI, is required by most lenders whenever a borrower obtains a loan with a down payment of less than 20 percent. The insurance protects the lender—or the ultimate buyer of the loan, giant investors such as Fannie Mae

*Thousands of homeowners nationwide continue to be charged for insurance coverage long beyond the point when their equity exceeds 20 percent, congressional estimates show.*

and the Federal Home Loan Mortgage Corp. (Freddie Mac)—from loss in the event of a borrower's nonpayment of principal and interest. Home buyers pay all the premiums for the coverage; lenders are the sole beneficiaries of any insurance payout.

However, once a homeowner's equity stake in the property exceeds 20

See HARNEY, E3, Col. 1

THE NATION'S HOUSING

# Congress May Give Homeowners Protection From PMI Overcharges

HARNEY, From E1

percent—either through amortization of the loan principal or through an increase in the resale value of the property—the lender is relatively safe from loss. Even if the home has to be sold at foreclosure, the insurance policy usually will cover much, or all, of the lender's loss exposure.

Yet according to congressional estimates, thousands of homeowners nationwide continue to be charged for insurance coverage long beyond the point when their equity exceeds 20 percent. Hansen cites the case of one unsuspecting homeowner who was still being charged for PMI premiums when her equity was 90 percent of her home value.

An eye-opening new estimate of the extent of the problem came last week when a Dallas-based loan portfolio analyst said he believes that as much as one-fifth of some lenders' mortgage portfolios consist of PMI-insured loans with equities that are greater than 20 percent of current market resale value. Lewis Hill, president of First American Tax Valuation Co., said in an interview that in one recent analysis of a 20,000-loan portfolio he performed, PMI was still being collected on about 4,000 loans where the assessed property valuation of the home put the borrowers' equity at or above the 20 percent mark.


BY WILLIAM T. COULTER

While not all those borrowers may be eligible for insurance cancellation—some loan documents prohibit insurance termination during the life of the mortgage—Lewis believes many should be eligible.

The problem: Very few borrowers understand their rights to cancel their insurance, in part because their lenders or loan servicers have never explained it to them. Both the Hansen and D'Amato bills would require periodic disclosure of those rights, as well as the conditions of eligibility for cancellation.

Some industry analysts say the keys to reform in the PMI arena rest not with lenders or insurers,

beneficiaries of PMI coverage—Fannie Mae and Freddie Mac. For several years, both firms have provided guidance on PMI cancellation to their loan servicers—the mortgage companies that collect the monthly payments and administer the millions of home loans owned by the congressionally chartered giant investors. Both companies generally allow qualified borrowers who can demonstrate equity levels of 20 percent or more to apply for premium cancellations.

But neither firm has sought to require its servicers to educate borrowers directly about the mechanics or eligibility standards

Fannie Mae took the first steps toward such a pro-consumer stance. In a confidential memorandum circulated to a small group of mortgage industry executives, it proposed an automatic cancellation and annual disclosure program similar to the one outlined in D'Amato's bill.

Spokesmen for Fannie Mae and Freddie Mac said last week that they support the objectives of the D'Amato bill. The bill's disclosure and automatic cancellation provisions would take effect 180 days after enactment of the legislation—raising the possibility that thousands of homeowners across the country could benefit

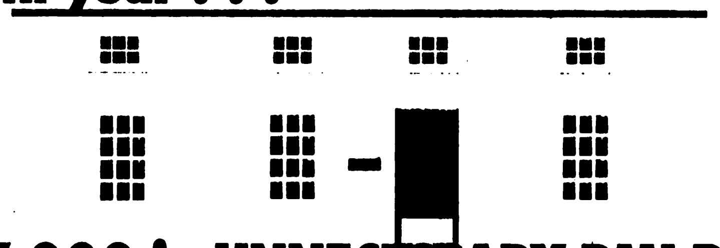
**$100,000 30 Year Mortgage**

**10% Down Payment**

**PMI Premiums: $350 Per Year**

**30 Year Total = $10,500 PMI Payments**

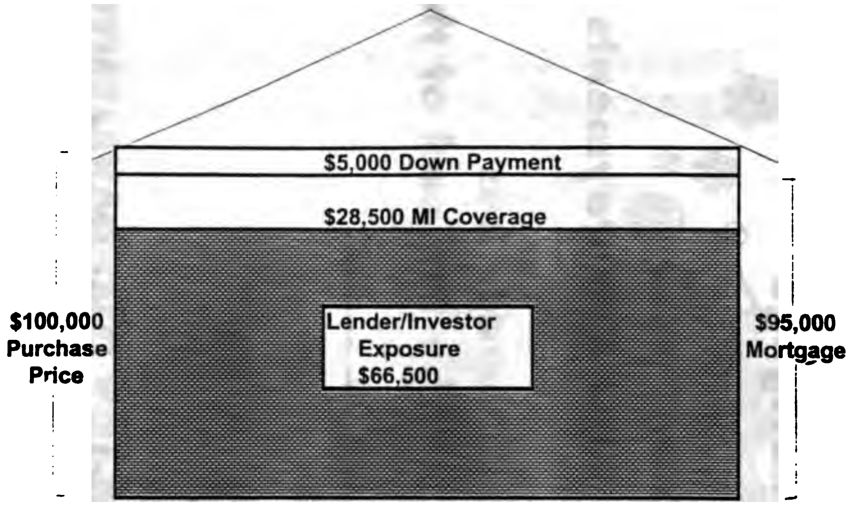
**Bottom Line: If the homeowner has accumulated 20% equity by the end of the tenth year . . .**



**$7,000 in UNNECESSARY PMI PAYMENTS**

SOURCE: ESSENTIALS OF REAL ESTATE FINANCE, 1996

## How Mortgage Insurance Works

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# STATEMENT OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM ON S. 318, THE HOMEOWNERS PROTECTION ACT OF 1997

FEBRUARY 27, 1997

The Board of Governors of the Federal Reserve System has been asked to comment on S. 318, private mortgage insurance legislation, which would amend the Truth-in-Lending Act. The bill seeks to protect homeowners from paying for private mortgage insurance when they have paid down the outstanding balances on their home purchase loans to a specified level.

**Background on Private Mortgage Insurance**

Before extending a home mortgage loan, lenders typically require borrowers to make a sizable downpayment to reduce the risk of default and the amount of any resulting loss. For conventional mortgages, lenders usually require a downpayment of 20 percent of the home's appraised value, but will accept smaller downpayments if mortgage guarantee insurance is purchased. Many first-time homebuyers and low-income households rely heavily on mortgage insurance because they often lack the funds for a sizable downpayment.

Private mortgage (guarantee) insurance or "PMI" protects lenders and investors on conventional mortgages. PMI is paid by the borrower to the lender who passes the premium payment on to the mortgage insurance company. Premiums vary with the purpose of the loan, the loan-to-value ratio, the length of the loan, as well as the amount of coverage required by the lender. In large part, the terms of private mortgage insurance are based on requirements set by Fannie Mae (formerly the Federal National Mortgage Association) and Freddie Mac (the Federal Home Loan Mortgage Corporation). Eight companies compose the private mortgage insurance industry in the United States. The Federal Housing Administration (FHA) and the U.S. Department of Veterans Affairs (VA) also insure home loans.

Private mortgage insurance plays an important role in the U.S. housing market. Based on industry sources, the private mortgage insurance industry extended coverage on nearly 900,000 of the roughly 4.4 million mortgages used to buy single-family homes in 1995. For mortgage loans of all types, loans with private mortgage insurance represented 55 percent of the insured loans.

Typically, mortgage lenders and investors are willing to cancel private mortgage insurance when homebuyers can document that they have achieved a 20 to 25 percent equity stake in the property and that they are current in their mortgage payments. The probability of default on a mortgage and resulting losses are closely tied to the level of equity a homeowner has accumulated in the property. Equity levels can be a function of the size of the initial downpayment, amortization of the loan principal, or changes in home values. Although home values generally rise over time, periods of significant declines in home values do occur and can quickly erase the equity a homeowner acquired initially or accumulated through principal reduction. For example, after peaking in 1991, the median value of existing homes in the Los Angeles metropolitan area (excluding the values of new homes) fell more than 10 percent by 1993, and more than 20 percent by 1996.

The default rates for mortgage loans vary directly with loan-to-value ratios. Over time the average default rate on mortgages with initial loan-to-value ratios of 80 percent or less is slightly less than 1 percent. Data show that mortgages with an initial loan-to-value ratio of 95 percent are 3.5 times more likely to default than mortgages with loan-to-value ratios of 80 percent. The typical loss to the lender following default and foreclosure on a conventional mortgage is equal to about 40 percent of the original loan balance. The amount paid by the insurer is governed by the insurance contract, but ordinarily covers between 50 and 60 percent of the total loss.

**Summary of Provisions in S. 318**

S. 318, the "Homeowners Protection Act of 1997," would amend the Truth-in-Lending Act to create a Federal standard for when creditors may require homebuyers to purchase private mortgage insurance as a condition to obtaining a loan secured by their home. The bill would also provide future homebuyers a right to cancel the coverage in certain circumstances. Specifically, homebuyers could not be required to obtain private mortgage insurance if the principal balance on their loan is less than 80 percent of the mortgaged property's value at the time the transaction is consummated, nor could they be required to maintain coverage when that loan balance is reached. The Board would be authorized to exempt certain classes of transactions from this standard, and presumably to set a different one, to ensure sound underwriting standards or further the availability of mortgages to persons

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who might otherwise be denied credit. These provisions would apply only to privately issued mortgage insurance, and not to Government insurance made available under the National Housing Act.

S. 318 would also require creditors to provide disclosures informing consumers of their right to cancel the insurance and the procedures to follow. (On existing loans, borrowers would be informed if they have any right to cancel and procedures for exercising that right.) Disclosures would be given at the time the loan is consummated and periodically thereafter.

**Additional Disclosures Required by S. 318**

With respect to a disclosure requirement, the Board agrees that consumers should be aware of the circumstances under which they may cancel mortgage insurance as well as the procedures for doing so. Consumers may not always be aware of such details. Even if information is provided with loan documentation, due to the large volume of documents presented at the loan closing, any description of their rights may be difficult to find in the documentation. The context in which a disclosure is made has an impact on its effectiveness or usefulness. A disclosure about mortgage insurance that is merely one part of a more detailed set of disclosures might be less effective than giving the same information in a segregated format (regardless of the timing of the disclosure). Having a description of the borrower's cancellation right on periodic statements provided by the loan servicer, as required by the bill, would further assure awareness of the cancellation privilege. But any new disclosure requirements should also take into account the additional cost of compliance for creditors and loan servicers, costs that are ultimately passed on to consumers. The cost of compliance with respect to older transactions may be higher if the relevant information is not readily available to the loan servicer.

**Regulation of Loan Underwriting Standards**

S. 318 would go beyond establishing disclosure requirements, by legislating a uniform Federal loan underwriting standard. The bill would prohibit creditors from requiring borrowers to obtain (or maintain) private mortgage insurance when a homebuyer's equity represents 20 percent or more of the property's value. Lenders and investors would have no discretion on their own to vary this standard in individual cases or for a particular class of transactions. The bill would require the Board to issue special rules for particular classes of transactions for a lender to deviate from the statute's uniform standard.

This legislative approach raises the fundamental issue of whether the Government should mandate underwriting standards, or whether this task is better suited for the market. Certainly, the market operates more efficiently when consumers are aware of their rights and responsibilities, and we trust that improved disclosures would assist in that process. On balance, the Board favors an approach that encourages consumer awareness and allows market conditions to determine the amount of equity that a consumer must have for a lender to consider mortgage insurance unnecessary.

We note that existing guidelines issued by Fannie Mae state that loan servicers must cancel private mortgage insurance (for a first mortgage) if the homebuyer requests cancellation and the unpaid principal balance has been paid down to 80 percent of the original value of the property. Thus, these guidelines have the effect of establishing rights similar to those contained in S. 318, with several differences. The guidelines do not require any disclosure to consumers regarding their right of cancellation. The guidelines also require that the consumer be current with mortgage payments and allow the loan servicer to require a current property appraisal if the servicer believes it is necessary to assure that the property has retained its value. Freddie Mac has somewhat similar guidelines.

In contrast, S. 318 would establish the original property value and the unpaid principal balance on a loan relative to that value as the sole basis for determining whether the consumer has acquired the necessary equity. If real estate values decline, some consumers with equity of less than 20 percent would be permitted to cancel the mortgage insurance. For example, if the original value of property securing the loan was $100,000, once the consumer's unpaid principal balance reached $80,000, the consumer would have the right to cancel private mortgage insurance regardless of the current home value, which may or may not be $100,000. Because this could have implications for creditors' risk of loss and their financial soundness, we believe lenders should be given an opportunity to take account of any decline in the property value in determining whether mortgage insurance may be canceled, and to take account also of a consumer's payment history on the loan. We also note that under the approach taken in S. 318, if real estate values increase, some con-

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sumers may continue to pay mortgage insurance premiums even after their equity is greater than 20 percent.

Under S. 318, if the basis for cancellation is the original property value, the precise loan balance that will give rise to the right to cancel is also known at the outset. Under that approach, once the PMI ratio is met, both consumers and creditors could benefit from allowing creditors to automatically cancel the insurance without notifying consumers of their cancellation rights.

**Conclusion**

Overall, the Board supports improving disclosures pertaining to private mortgage insurance. Consumers should be informed of their right to cancel the insurance and the means for exercising that right. Should Congress proceed with legislation, the Board favors a more flexible approach which would allow market conditions to guide the lender's underwriting standards in setting the amount of equity that a consumer must have to avoid mortgage insurance. If a uniform Federal standard is established, however, the Board recommends allowing lenders to verify that no decline in the property value has occurred and that there is no delinquency before the mortgage insurance is canceled.

We note that the proposal would be an amendment to the Truth-in-Lending Act, which may be appropriate given that the bill would require disclosures in connection with the loan closing. Nevertheless, to the extent new substantive restrictions are placed on the mortgage underwriting process, amending the Real Estate Settlement Procedures Act, which regulates certain aspects of the mortgage process, may be more appropriate. In addition, if the disclosures mandated by S. 318 are intended to be made in connection with loan servicers' annual escrow statements, the requirements for those statements are contained in the RESPA, not in the TILA.

The Board also believes, regardless of the statute being amended, a number of technical revisions are needed to clarify the meaning of several provisions of S. 318. For example, in calculating the private mortgage insurance ratio, it is not clear whether the "original value" of the property securing the loan refers to the original purchase price or the appraised value at the time the loan was consummated. Also, the bill should clarify what effect it is intended to have on State laws. The Board's staff would be glad to assist the Committee in reviewing details of any revised legislation which amends the Truth-in-Lending Act and making recommendations with respect to the technical language of the bill.

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## STATEMENT OF ANN LOGAN

EXECUTIVE VICE PRESIDENT AND CHIEF CREDIT OFFICER, FANNIE MAE

FEBRUARY 25, 1997

Thank you for giving me the opportunity to comment on S. 318, the Homeowners Protection Act of 1997. Fannie Mae applauds Senator D'Amato's leadership on an issue of great importance to consumers, and we look forward to working with him and the other Members of the Banking, Housing, and Urban Affairs Committee to resolve it to the benefit of current and future homeowners.

Fannie Mae's mission is to expand homeownership opportunities for more low-, moderate-, and middle-income families. Many of the families we now serve are very well qualified to own a home, but have not been able to save a downpayment of 20 percent. To help these families achieve their dream of homeownership, we offer low-downpayment mortgages. Borrowers can get these loans with downpayments as low as 3 percent. However, low-downpayment borrowers must maintain mortgage insurance to protect the lender and the mortgage investor in case of default. About one in every three loans we purchase or guaranty each year has mortgage insurance. Typically, this mortgage insurance costs $28 to $76 a month for a $100,000 mortgage, depending on the size of the downpayment, and must remain in place until the borrower has at least 20 percent equity in their home.

Many borrowers pay for mortgage insurance far longer than necessary. We are committed to ending these unnecessary payments. That is why we initiated a policy review aimed at eliminating any practice that results in homeowners paying for mortgage insurance longer than necessary. Working with the lenders, the mortgage insurers, and others, we have developed a new approach to Fannie Mae policies governing mortgage insurance. Our work has been guided by four key principles.

First, **information**. We believe the mortgage finance industry has a responsibility to educate borrowers about mortgage insurance—what it is, how it helps them buy a home with a smaller downpayment, and how it can be canceled. To achieve this goal, Fannie Mae will soon issue specific servicer guidelines requiring that mortga-

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gors whose loans are sold to us be informed that their loan has mortgage insurance that can be canceled when certain conditions are met. We will insist that this disclosure be made at the time of origination and in an annual reminder to borrowers.

Second, **fairness**. We believe borrowers who amass equity equal to 20 percent of their home's **original** value should be treated the same way as borrowers who make a 20 percent downpayment at the outset of the loan. Therefore, we allow servicers to cancel mortgage insurance for any borrower with a good payment history when the loan balance reaches 80 percent or less of the original value, whether through prepayment or amortization.

Third, **shared responsibility**. Fannie Mae wants to make sure that no homeowner pays for mortgage insurance that is no longer necessary. To achieve this, we will have our servicers automatically cancel mortgage insurance on any loan that reaches its "half-life" (e.g., 15 years for a 30-year mortgage) and is current.

Fourth, **recognition of market value**. We believe that a homeowner should be able to have their mortgage insurance canceled when the market value of their home increases to the point where mortgage insurance is no longer necessary. To arrive at a policy that protects consumers and investors in mortgages alike, we must gain greater confidence in the accuracy of the market appraisal of home values. The market value of a home is difficult to estimate in the absence of an actual sale; even under the best of circumstances, property appraisal is not an exact science. It is reasonable to expect that appraisals might produce a value range 5 to 10 percent above or below the true market value. This complicates the use of market values in mortgage insurance cancellation. We also are mindful of what we have witnessed over the past decade in California and portions of the Northeast, where a rapid increase in home values was followed by a precipitous decline.

Therefore, our policy will balance the need to allow homeowners to benefit from the market appreciation of their asset and the need to keep lenders and mortgage investors from being exposed to an increase in uninsured losses.

The four principles outlined above guide Fannie Mae's commitment to ensuring that homeowners only pay for mortgage insurance as long as they need it. We believe our principles and policies are consistent with S. 318, the Homeowners Protection Act of 1997, and we support Chairman D'Amato's efforts. In so doing, we hope to help resolve some technical aspects of the legislation and remove any unintended regulatory burdens. Specifically, we want to make sure that nothing in the legislation inhibits our ability to target the best low-downpayment mortgage products to lower-income borrowers. In many cases, a "deeper" mortgage insurance requirement is a key element of the sound underwriting of mortgages for first-time homebuyers and others who wish to make smaller downpayments.

In the weeks ahead, we will communicate to servicers our new policies requiring that consumers be fully informed about their mortgage insurance, especially about their ability to cancel it when they have equity in their home equal to 20 percent of the home's original value. We will communicate our policy change requiring that mortgage insurance be canceled automatically at the mid-point of the loan. We look forward to developing and announcing a new policy for addressing mortgage insurance cancellation based on a home's current market value. And we look forward to working with Senator D'Amato and the Committee on ways consumers can be protected while maintaining access to the American dream through homeownership.

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## STATEMENT OF FREDDIE MAC ON S. 318, THE HOMEOWNERS PROTECTION ACT OF 1997

FEBRUARY 25, 1997

Freddie Mac appreciates this opportunity to submit our views on the Homeowners Protection Act of 1997 (S. 318). We support Senator D'Amato's efforts to ensure that mortgage borrowers are adequately informed of their ability to cancel, under appropriate circumstances, private mortgage insurance. The Homeowners Protection Act requires important new uniform nationwide disclosures to mortgage borrowers concerning their ability to cancel private mortgage insurance. By providing consumers with critical information at the time they obtain a mortgage and at least annually thereafter, borrowers' understanding of their ability to terminate private mortgage insurance will be greatly enhanced.

Freddie Mac believes that risk-sharing arrangements, such as private mortgage insurance and other credit enhancements, provide essential tools to expand homeownership opportunities for millions of American families. These arrangements open up new sources of financing for low-downpayment mortgages by reducing the cost associated with borrower default to mortgage lenders and other investors in mort-

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gage loans. Lenders and investors are more willing to provide capital for riskier low-downpayment loans because the cost of borrower default is shared in part by private mortgage insurance.

Freddie Mac uses private mortgage insurance and similar products to open doors to homeownership for first-time homebuyers and others who do not have the historical 20 percent downpayment for a home. In 1996, 43 percent of all families who obtained a conventional mortgage to purchase a home had less than a 20 percent downpayment.

Freddie Mac believes that borrowers should be able to cancel private mortgage insurance under appropriate circumstances. In fact, our guidelines require a mortgage servicer to cancel private mortgage insurance in response to a borrower's request under a range of circumstances based on, among other things, the age of the loan, the value of home improvements, the amount of equity in the home at the time of the request, and the borrower's history of timely mortgage payments.

Accordingly, Freddie Mac supports the intent of the Homeowners Protection Act to help mortgage borrowers understand their ability to cancel private mortgage insurance. Specifically, the legislation requires that at the time the mortgage loan is originated lenders provide borrowers with information about their ability to cancel private mortgage insurance. The legislation also requires servicers to provide borrowers with at least annual notification of their ability to cancel private mortgage insurance.

While Freddie Mac applauds the goals of requiring timely and meaningful consumer disclosure and notice, we are concerned with provisions which appear to establish a fixed standard for requiring or maintaining private mortgage insurance. S. 318 establishes a "private mortgage insurance ratio" equal to a principal balance outstanding on a residential mortgage that is 80 percent or less of the original value of the property securing the loan. Creating a fixed ratio in the law will remove the flexibility currently available in the mortgage markets to tailor private mortgage insurance requirements to meet the needs of homebuyers, lenders, and mortgage investors. Under this legislation, the ability to design and offer new innovative mortgage products that require private mortgage insurance might be lost.

Freddie Mac is also concerned that S. 318 sets the "private mortgage insurance ratio" based solely on the value of the property at the time the mortgage was originated. In changing economic conditions, real estate values can fluctuate widely in relatively short periods of time. For example, a family who purchased a home in a market with declining real estate values, such as California during the past decade, would have experienced an increase in its loan-to-value ratio as a result of these economic circumstances. Under the legislation, the mortgage borrower would be able to cancel their private mortgage insurance even though the risk of default had increased dramatically. Conversely, a family whose home value appreciated substantially would not be able to take advantage of the current market value to cancel their private mortgage insurance since the legislation relies solely on the original value of the home.

Freddie Mac looks forward to working with Senator D'Amato and the Members of the Senate Banking Committee on this important legislation designed to help borrowers to better understand their ability to cancel private mortgage insurance while preserving the role of private mortgage insurance in expanding homeownership opportunities for all Americans.

### Response to Written Questions of Senator D'Amato From Freddie Mac

**Q.1.** In your statement which you submitted to the Committee, you discuss your concern that a fixed ratio (80 percent or less of the original value of the property securing the loan) for requiring or maintaining private mortgage insurance would diminish "the flexibility currently available in the mortgage markets to tailor private mortgage insurance requirements to meet the needs of homebuyers, lenders, and mortgage investors." Also, you express concern that "the ability to design and offer new innovative mortgage products that require private mortgage insurance might be lost."

Please expand on how a fixed ratio would diminish flexibility and hinder the ability of insurers to offer new mortgage products.

**A.1.** Risk-sharing arrangements, such as private mortgage insurance and other credit enhancements, provide essential tools to expand homeownership opportunities for millions of American families. These types of risk-sharing arrangements provide the mortgage industry with much-needed flexibility to tailor mortgage products for potential homebuyers who do not have the funds necessary for a "traditional" 20 percent downpayment.

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Risk-sharing arrangements, such as private mortgage insurance, help to offset a portion of the losses incurred by lenders and investors when a borrower defaults. Without such risk protection, lenders would be unwilling to bear the risk of borrower default or otherwise face large inventories of foreclosed properties generating large losses. We are concerned that statutorily imposing a fixed ratio for canceling mortgage insurance will take away the market's ability to structure cancellation policies commensurate with empirical default loss experience.

Without the flexibility to tailor risk-sharing arrangements, lenders and investors would be deterred from experimenting with higher-risk loan programs because they could not confidently predict performance and control their loss exposure where they have no experience. This unwillingness to experiment—to take on uncertain or new risks—is likely to dampen efforts to expand homeownership to traditionally underserved populations.

For example, in changing economic environments, real estate values can fluctuate widely in relatively short periods of time. A family who had 20 percent equity in their home in Los Angeles, California in 1990 and therefore had a loan-to-value ratio of 80 percent would have seen their loan-to-value ratio increase to 99 percent in 1995 as a result of declining property values.

In designing higher-risk mortgage products (e.g., low-downpayment mortgages), the ability to customize mortgage insurance coverage enables many borrowers to get financing who might have otherwise been denied credit. The mortgage finance industry uses mortgage insurance to create unique products tailored to meet special housing needs.

Freddie Mac uses mortgage insurance to create new mortgage products and to structure unique transactions. For example, we partner with entities such as the California Housing Finance Agency, Massachusetts Housing Finance Agency, and the Baltimore City Residential Finance Mortgage Revenue Bond program to structure novel financing mechanisms which meet the particular needs of homebuyers in those locales. Absent these types of efforts, some underserved communities would simply not have access to innovative forms of residential financing.

Other mortgage products which are generally considered to pose higher risks, such as cash-out refinancings and balloon mortgages, would be unavailable to homebuyers were it not for credit enhancements like private mortgage insurance. Alternatively, these types of financing would be available at significantly higher interest rates to compensate lenders for greater risks than those which are available through credit-enhanced programs.

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## STATEMENT OF THE AMERICAN BANKERS ASSOCIATION ON S. 318, THE HOMEOWNERS PROTECTION ACT OF 1997

FEBRUARY 25, 1997

The American Bankers Association ("ABA") applauds Senator D'Amato for holding the February 25, 1997 hearing on the important issue of private mortgage insurance ("PMI") and on his bill, S. 318. That bill prohibits creditors from requiring mortgage borrowers to obtain or maintain PMI once the equity in the home reaches a certain level. The bill also requires service providers to inform consumers that they may cancel private mortgage insurance once the loan-to-value ratio falls to 80 percent or less.

ABA brings together all elements of the banking community to best represent the interests of this rapidly changing industry. Its membership—which includes community, regional, and money center banks and holding companies, as well as savings associations, trust companies, and savings banks—makes the ABA the largest banking trade association in the country.

ABA agrees with the intent of the legislation that mortgage borrowers should be able to cancel PMI once the loan-to-value ratio reaches a certain level and also that consumers should be informed of this right. The benefits of PMI and the ability to cancel it at the appropriate time are important to both consumers and lenders.

We are concerned, however, that what may look like a simple and effective solution may have unintended and adverse consequences. Any legislative cure should be thoroughly reviewed and appropriately modified before enactment. It is important that legislation not inadvertently create unacceptable risks or burdens for mortgage lenders and service providers. ABA is eager to work with Senator D'Amato, the Senate Banking Committee, and their respective staffs to craft a workable and effective solution.

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**Summary**

While supportive of the goals of S. 318, as lenders and service providers, banks are concerned that absent corresponding changes to secondary mortgage market guidelines, S. 318 would compel them to cancel PMI contrary to their agreements with mortgage investors such as Freddie Mac and Fannie Mae. Service providers could then be responsible for losses in the event of a default. While Fannie Mae and Freddie Mac have proposed changes to the service provider guidelines that would address these concerns, they are not yet in effect.

In addition, we believe that there are other issues which must yet be resolved before enacting legislation. These include, for example, whether the loan-to-value ratio should be based on the current value of the property or, as the bill provides, on the value of the property at the time of the original transaction. Even if an appropriate loan-to-value ratio triggering PMI cancellation can be determined, exceptions will be necessary to address riskier situations. Also, it may not be practical for PMI to be canceled automatically as the bill envisions. The issue of the liability associated with the Truth-in-Lending Act for even good faith violations must be addressed. Also, it is not clear whether or how the bill should apply retroactively to existing mortgages. Any solution should provide for a single uniform law.

ABA strongly believes that any disclosures related to PMI cancellation should be provided at a time when consumers will most likely absorb the information. Moreover, they should be provided in such a manner as to minimize the burden on mortgage lenders. Accordingly, we suggest that mortgage borrowers receive an **annual** notice which states that they may be able to cancel PMI and explains how they may initiate that process. Providing disclosures at settlement is unnecessary.

**Background**

In essence, PMI is insurance which protects mortgage lenders in the event that a borrower defaults. If the borrower fails to repay a mortgage, the PMI provider pays the lender a specified percentage of the loss. PMI is usually required when the borrower's downpayment is below a certain percentage of the value of the home at the time the loan is made. Twenty percent is typical, but the percentage may vary. PMI may also be required for a mortgage refinancing when the loan-to-value ratio exceeds a certain level. Secondary market investors often waive the PMI requirement once the loan-to-value ratio falls below a requisite level.

The rationale for PMI is that lenders are at greater risk when a borrower has a downpayment or equity worth less than 20 percent of the property's value.

First, in the event of a default and foreclosure, with less than 20 percent equity, creditors are less likely to recover their costs because of the expenses and procedures associated with foreclosure.

Second, borrowers are more likely to continue mortgage payments when they risk losing valuable equity they have built up in their home.

PMI has permitted many consumers, particularly first-time buyers and low- and moderate-income consumers, to own their own home. One of the greatest obstacles for many low-income and moderate-income consumers is a downpayment requirement. While potential homeowners may have adequate income to make the monthly payments, they lack up-front cash. PMI allows more consumers to buy homes by lowering the downpayment needed to obtain a mortgage and by lowering the cost of such mortgages.

PMI usually may be canceled once the loan-to-value ratio reaches a certain level, typically 80 percent. For most mortgagors, PMI cancellation never becomes an issue because the loan-to-value ratio never reaches that level. Most consumers either refinance or buy a new home before the loan-to-value ratio has reached a sufficient level to cancel PMI: the average mortgage only lasts about 7 years while it usually takes at least 10 years before the loan-to-value ratio falls to 80 percent.

The concern raised is that some consumers are unaware that PMI may not be required once the loan-to-value ratio falls to the requisite level and they continue to make unnecessary payments. To address this, S. 318 prohibits lenders from requiring borrowers to obtain or maintain PMI if the outstanding loan balance equals or is less than 80 percent of the value of the original property. In effect, PMI must be canceled automatically. In addition, the bill requires that consumers be informed that they may cancel PMI.

**Discussion of S. 318**

*Secondary Mortgage Market Requirements*

The ABA's first concern about the proposal relates to the service providers' lack of control over the PMI requirement and the liability that they may face if they are required to cancel it without waivers from secondary market investors.

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Recent proposed changes to the secondary service market guidelines may alleviate these concerns, but they are not yet in effect. In addition, their adoption may vitiate the need for legislation.

Original mortgage lenders, such as banks, do not usually require PMI. Rather, PMI is typically a condition imposed by secondary market mortgage lenders, such as Fannie Mae and Freddie Mac. Yet, the bill does not apply to these secondary market lenders. If the investors do not agree to waive the PMI, under the bill's automatic PMI cancellation provision, service providers could then become responsible for losses in the event of a default. Given this risk, many lenders would avoid making mortgages with downpayments less than 20 percent of the purchase price.

Fannie Mae's and Freddie Mac's recently proposed revisions to servicer guidelines regarding PMI cancellation would address most of these concerns. It is our understanding that the revisions under consideration allow service providers to waive PMI once the loan-to-value ratio falls to 80 percent (based on the property's value at the time of the original transaction). In addition, PMI may be canceled automatically if the borrower has successfully continued payments for the first half of the loan term. We believe that these proposed changes are positive steps that address banks' concerns about canceling PMI absent the consent of the secondary market investors.

*Calculating the Loan-to-Value Ratio*

In addition to the potential risks associated with canceling PMI, the bill poses other issues, for example, how to determine the value of the property when calculating the loan-to-value ratio. The question is whether the determination should be based on the value of the property at the time of the original transaction or on its current value.

There are advantages and shortcomings to both options.

Basing the ratio on the current value poses the issue of determining the property's current value. Who determines the current value? If an appraiser, who pays for the appraisal report? What type of appraisal is sufficient? What if appraisal reports differ? If service providers must automatically cancel the PMI once the loan-to-value ratio reaches a certain level, how often must appraisal reports be obtained? Given the subjective nature of appraising property values and the liability provisions of the Truth-in-Lending Act, banks are concerned that a proposed automatic PMI cancellation based on the current value of the property will promote costly lawsuits notwithstanding good faith efforts of lenders and service providers to appraise the property.

Relating the ratio to the value of the property at the time of the original transaction is more objective and helps to avoid many of these issues, particularly the potential costly liability. However, this erroneously assumes that real estate values never fall. Yet, as brought out in the Committee hearing, property values can fall, in which case loan-to-value ratios based on current property value may be greater than 80 percent, even if the loan-to-value ratio at the time of the transaction was less than 80 percent. Moreover, borrowers tend to be more likely to default when the loan balance exceeds the property's value. In these cases, allowing PMI cancellation may vitiate the purpose and value of PMI.

Equally, basing the loan-to-value ratio on the value of the property at the time of the original transaction will disadvantage borrowers: they cannot take advantage of rising real estate values or home improvements to cancel PMI earlier.

Another issue is determining the appropriate loan-to-value ratio that triggers PMI cancellation. While 80 percent is fairly typical, there are those circumstances when a lower loan-to-value ratio may be warranted—for second homes, for example. Moreover, there are other circumstances when PMI should be continued notwithstanding the low loan-to-value ratio. For example, the borrower's payment history may be an indication that the loan is at risk. In any event, there must be flexibility to allow variations and exceptions.

*Party to Be Responsible for PMI Cancellation*

Also to be determined is the party responsible for initiating PMI cancellation, the borrower or the service provider. If PMI cancellation is based on the current property value, making service providers responsible for cancellation would be extremely expensive. As a practical matter, service providers would have to obtain expensive appraisal reports on a frequent periodic basis.

The potential liability, even for good faith errors, would compel that thorough, frequent, and expensive appraisal reports be obtained. In many cases, the routine appraisal reports would simply represent an exercise to protect against the risk of liability since in most cases the loan-to-value ratio will be insufficient to cancel PMI. Appraisal reports would be obtained simply on the basis of a legal requirement and

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potential liability, not on the likelihood that PMI cancellation may be appropriate. Ultimately, if service providers are required to automatically cancel PMI based on a loan-to-current-value ratio, consumers would directly or indirectly absorb these costs.

In this case, it would be far more efficient and practical for the consumer rather than the service provider to judge when the loan-to-value ratio is approaching a level which allows PMI cancellation: customers are more familiar with local real estate trends, the estimated value of their home, and the outstanding balance on their mortgage. This information, coupled with an annual notice of the right to cancel the PMI, would equip consumers to initiate the PMI cancellation process at the appropriate time.

Also to be considered are operational obstacles to automatic cancellation regardless of how the loan-to-value ratio is determined. For example, it isn't clear whether service providers have access to all the data necessary to calculate the loan-to-value ratio on a routine basis.

*Retroactive Application*

It is also not clear whether it is legal, appropriate, or fair to apply retroactively the proposed prohibition to existing mortgages. Legislation would in effect change the terms of existing contracts. Also, because legislation is effective upon enactment, service providers would immediately be in violation.

*Disclosures*

Disclosure requirements pose other issues. First, if PMI cancellation is automatic, no disclosure is necessary. Second, it is critical that consumers receive any information at a "teachable moment," that is, when they are most likely to read and absorb the information.

For example, S. 318 requires that the PMI notice be provided at the time of mortgage consummation. Adding it to the eye-glazing pile of legally-required and other documents mortgage borrowers currently receive at settlement is not useful to most consumers. One more disclosure simply distracts consumers and dilutes the effectiveness of all the disclosures. Moreover, PMI information is less likely to register with consumers at settlement since the opportunity to cancel the PMI is often years away.

An annual notice such as the one required in S. 318 is a far more effective approach since a periodic reminder will reinforce the cancellation right. In addition, an annual notice helps to minimize the burden on service providers. For example, lenders could include the PMI notice with the required IRS notice that indicates the amount of interest the consumer paid that year. Similarly, they could choose to include it on a periodic statement.

ABA also suggests deleting the requirement that service providers send a special notice to existing mortgage borrowers. It is an unnecessary and expensive burden on service providers. Pursuant to the bill, existing customers will already receive an annual notice. It is not necessary or useful that they receive two notices, especially if they are in rapid succession, a possible event depending on the date of the bill's enactment. The limited and duplicative benefit does not justify the costs of a special mailing.

We also recommend that the bill allow service providers the option of including the PMI notice in a periodic statement in lieu of an annual notice. This flexibility helps service providers minimize their costs without detracting from the effectiveness of the PMI notice.

*Federal Preemption*

It is also critical that legislation ensure a single uniform law on PMI cancellation and notice requirements. Varying multiple State and Federal laws are unnecessarily burdensome and confusing to both consumers and service providers. Accordingly, we strongly recommend that any legislation preempt any State laws which are related to PMI cancellation.

American Bankers Association appreciates the opportunity to express our views on S. 318 and the important issue of private mortgage insurance. We are eager to work with Senator D'Amato and the Senate Banking Committee to ensure that consumers are able to cancel PMI at the appropriate time. We are also interested in providing comments on how to achieve this goal in a manner that is effective and that minimizes the costs and risks for both service providers and borrowers. We look forward to working with Senator D'Amato and the Senate Banking Committee on this matter.

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## STATEMENT OF RICHARD J. ROLL
### PRESIDENT, AMERICAN HOMEOWNERS ASSOCIATION
### FEBRUARY 25, 1997

Chairman D'Amato, Members of the Committee, distinguished guests, I'm pleased to submit this testimony for the February 25, 1997 Senate Banking Committee hearing concerning private mortgage insurance (PMI) abuses on behalf of AHA, the American Homeowners Association.

Over the past 4 years, we have been made aware of PMI abuses which occur at every stage of the mortgage process. This knowledge has come through the experiences reported by our members and through thousands of mortgage audits which were conducted for consumers and AHA members in all 50 States. Senator D'Amato is to be praised for taking the initiative and introducing S. 318, the Homeowners Protection Act of 1997. Federal legislation requiring automatic cancellation and standardized disclosures at each stage of the mortgage process is urgently needed.

AHA was formed in 1994 to serve the needs and interests of homeowners across the Nation, who are facing a squeeze on both their budgets and their time. Today, we proudly serve thousands of dues-paying members in all 50 States with over 35 benefits and services, and are growing at a rate of over 1,000 members per week.

On behalf of our members, the millions of homeowners currently paying for PMI, and millions of additional American consumers who would like to become homeowners, AHA has actively worked to bring the issue of PMI overcharges to light for several years through our consumer information and the press. Today AHA released a special report homeowners can use to see if they can qualify to stop making these payments and save hundreds of dollars. This guide, along with the worksheet, can help thousands of homeowners qualify immediately to stop making these payments. This information has not been easily available to consumers.

PMI serves a very useful purpose for homebuyers who cannot afford the standard 20 percent downpayment on a home purchase. However, millions of homeowners are being required to continue these payments after they may be eligible to cancel them, resulting in overcharges amounting to hundreds of millions of dollars which these homeowners can ill afford. We strongly believe that loan servicers should be required to cancel PMI automatically when the loan balance is paid down below 75 or 80 percent of a home's resale value.

The experiences of AHA members underscore this problem. Private mortgage insurance is a confusing and obscure concept for most homeowners and homebuyers, who very often are overwhelmed in the swirl of a loan closing and are unclear that PMI is not flood, hazard, or mortgage life insurance. Many homeowners are not even aware that they are paying PMI.

Natalie Albert, an AHA member from New York, expressed the outrage shared by many homeowners across the Nation about the process of obtaining PMI.

> We had a history of paying early or on time. When we refinanced our home, after paying PMI on the original loan, our incomes were higher, and the borrowed amount was $10,000 less, but the monthly PMI charge was higher. We as the homeowner were to be paying for this insurance, but we were given no choice in selecting a carrier, and no reason for the higher charge. They would not even give me the name of the PMI carrier after I asked for it. It was all done in hazy secrecy. Even though we had no other debt, and an excellent payment record, when we went to refinance after 3 years they asked us to pay an up-front PMI fee again—again an up-front fee of 1½ times the annual PMI premium. I screamed and yelled, and finally they made an 'exception.' If this is insurance, premiums should be based on risk. But there was no risk basis to what we were charged. It was just a made-up number. To me, that's like legalized theft.

Another problem experienced by our members is illustrated by the experience of Raj Verma, an AHA member from Pennsylvania, upon discovering that he was continuing to pay PMI payments after his loan was paid down below 80 percent of his original purchase price.

> I've had my loan since 1985, paid $90,000 for my house, and the loan balance has been paid down to $62,000, which is less than 70 percent. My lender says the guidelines of the investor and the PMI company require me to continue paying PMI each month. But whose guidelines are they, and where can I find them? The lender has refused to tell me who the investor and PMI company are. From the recent sales in my neighborhood, I can easily show that my home is now worth $160,000. Where can I turn to stop making these payments?

A further problem is illustrated by both Connecticut AHA member Glen Marr, and Florida resident Nancy Ryan. In 1995, Mr. Marr sought to have his PMI discon-

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tinued because his home value had increased substantially through a combination of remodeling and real estate appreciation. When he asked his lender to discontinue PMI, he was told he would have to obtain a full appraisal at a cost of some $350 or more. With the lack of clear-cut guidelines from his lender specifying conditions for releasing PMI, Mr. Marr hesitated to incur the expense of an appraisal, since he and his wife were unsure if they would be selling in the near future or refinancing the home. He continues paying PMI every month, receiving no benefit, like many thousands of similar homeowners across America. Why invest in an appraisal at $350–$400 only to risk being refused or rebuffed by the lender? In Nancy Ryan's case, in the absence of clear-cut Federal standards, it took 4 long frustrating years of persistence for her to persuade her lender that PMI should be dropped.

AHA believes that remedies for the problems of PMI overcharges need to be addressed at four levels, comprising the investors who control it, the PMI companies that issue it, the originator who requires it, and the servicer who implements and administers it:

1. A standardized disclosure is needed at time of origination, which could take the form of a standardized booklet such as those already in existence for ARM loans, to be received by all borrowers required to pay PMI.
2. Annual disclosure thereafter specifically informing those who are paying PMI that they are paying PMI and that they may have the right to cancel it. Along with this should be a standardized communication guideline for servicers and their customer service staff relative to alternatives and procedures for cancellation of PMI.
3. Automatic cancellation when loan balance declines to below 80 percent of original value (or 75 percent in SMSA's designated by Federal Reserve Board for limited periods of time in the event of instability of property values).
4. Simplified burden of proof and acceptability guidelines for servicers to verify and validate property value, including low-cost streamlined "PMI appraisal."

None of the above is intended to reduce the safety and soundness levels of PMI underwriting. Therefore, provisions for owner-occupied versus non-owner-occupied and good pay history versus bad pay history should be taken into account in final legislation.

Private mortgage insurance, or PMI, is a blessing for many first-time homebuyers who can't make the standard 20 percent downpayment. By working together with both industry and Government officials to put an end to consumer abuses related to PMI overcharges, AHA believes we can all create a big win for homeowners and homebuyers without losing the legitimate value of PMI or creating an undue burden on the mortgage industry.

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## STATEMENT OF BOB KULICK

PRESIDENT, CALIFORNIA ASSOCIATION OF REALTORS®, LOS ANGELES, CALIFORNIA

FEBRUARY 25, 1997

### I. Introduction

As President of the California Association of REALTORS® (C.A.R.), a statewide trade association representing the interests of nearly 100,000 real estate licensees, I am very pleased to have the opportunity to present C.A.R.'s perspectives on S. 318 (D'Amato), the Homeowners Protection Act of 1997, which is pending before the Senate Banking Committee.

As trusted representatives of homeowners, sellers, and buyers, C.A.R.'s members are keenly interested in any laws, regulations, or business practices that affect an individual's ability to secure homeownership. Therefore, C.A.R., in conjunction with the National Association of REALTORS®, is pleased to support provisions of S. 318, legislation which would give homeowners the right to cancel unnecessary private mortgage insurance (PMI). Additionally, C.A.R. supports provisions that go beyond PMI cancellation rights and would also grant policyholders the ability to obtain the name of their mortgage insurance provider.

### II. The Homeowners Protection Act of 1997

Currently, when an individual secures a home loan with a downpayment that is less than 20 percent of the property's full price, the lender typically requires the borrower to also purchase mortgage insurance to protect the lender from loss in the event of a default and subsequent foreclosure.

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S. 318 specifies that consumers would not be required to obtain or maintain private mortgage insurance if that consumer has equity in the property in excess of the private mortgage insurance ratio (20 percent). Senator D'Amato's legislation stipulates that if a consumer is required to obtain and maintain private mortgage insurance as a condition for a home loan, the creditor must disclose the current private mortgage insurance ratio for the property and any such information as may be necessary to permit the consumer to communicate with the creditor or any subsequent servicer of the mortgage concerning the consumer's private mortgage insurance. Further, mortgage servicers would be required to provide annual notice to the consumer that he or she may cancel the private mortgage insurance. The bill specifies that no fees could be charged by a creditor to pay for the services included in the measure.

C.A.R. supports provisions in S. 318 that allow qualified consumers to cancel their PMI. We believe that homeowners too often pay excess mortgage insurance because they are unaware that they have the coverage or that they may have a right to cancel it. Consequently, homeowners across the United States continue to spend $50 to $100 a month for private mortgage insurance that they really do not need and, in some cases, are not legally required to pay.

It was this fact that motivated C.A.R. to sponsor legislation in California in 1988, 1990, and 1994 to address this problem. Under California law, homeowners are authorized to cancel their mortgage insurance when they meet specified requirements, including a minimum equity threshold, and must be notified of their right to cancel PMI by the servicer on an annual basis. California lawmakers implemented the State's mortgage insurance cancellation and disclosure law when it became apparent that lenders were refusing to cancel PMI even when home equity far exceeded the 20 percent equity level.

Like the existing and successfully-implemented California law, S. 318 would appropriately educate homeowners about their cancellation rights at the front end of the mortgage process and at least once a year thereafter. Simple common sense and fairness dictates that consumers should be allowed to cancel insurance coverage for which they receive no benefit.

It should be recognized that private mortgage insurance is an essential tool for those homebuyers who have fewer resources available for a large downpayment. In California, home costs and the associated downpayment requirements can be prohibitively high for many consumers. PMI affords first-time homebuyers the opportunity to buy a home using a low-downpayment loan because it gives lenders the confidence to offer loans to individuals who would not be approved otherwise. Importantly, it is these modest-income purchasers that are most in need of the protections provided by S. 318, because they are most likely to benefit from the additional resources that are freed-up when the PMI is no longer justifiable.

### III. Disclosure of the Mortgage Insurer Also Needed

In addition to the provisions currently included in S. 318, C.A.R. supports *further* disclosure requirements in conjunction with the PMI cancellation notice. Specifically, C.A.R. believes that lenders should also be required to disclose the name of the mortgage insurer used in connection with a home loan at the time the loan is made and annually thereafter. Providing customers with the name of their PMI company could be critical to certain homesellers involved in "short payoff sales" farther down the line.

Short payoff sales occur when a lender agrees to the sale of a property for a price below what is necessary to fully repay the remaining mortgage. Short payoff sales typically occur when property owners, through no fault of their own—job losses or transfers, health problems, divorce, etc.—need to sell their homes but find that their property values have decreased in value to amounts that are less than the original mortgages. Consequently, any sale leaves them unable to pay off the whole amount, resulting in a "short sale." Lenders often accept short payoffs in an effort to avoid the larger expense and potential problems associated with a foreclosure.

California REALTORS® helping individuals when selling or buying short payoff properties have pointed out that short payoff negotiations with lenders can be difficult and frustrating. Many times, protected by mortgage insurance, a lender has no interest in working out a compromise sale. As a result, the lender forecloses, the mortgage insurance company is faced with an expensive claim, and the borrower who has brought a "willing buyer" to the table is saddled with the negative credit history that a foreclosure brings.

Interestingly, private mortgage insurers can be the consumer's ally in the short payoff process because it is also in the PMI provider's best interest to avoid foreclosure. However, under current law, mortgage servicers are *not* required to divulge the name of the insurance provider to the borrower. Consequently, many troubled

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homeowners typically have no access to the mortgage companies that could have an interest in facilitating a short payoff sale.

In conjunction with N.A.R., C.A.R. supports amendments to S. 318 which would require mortgage lenders to disclose the name of the mortgage insurer used in connection with the mortgage loan on or before the date that the loan is closed and annually thereafter. Specifically, the measure should include a provision that would require mortgage servicers to provide such information as may be necessary ...

> to permit the consumer to communicate with the creditor, *any subsequent servicer of the mortgage*, and **the issuer of the private mortgage insurance** concerning the insurance.

As such, a small modification to the bill would allow homeowners to learn the name of the relevant mortgage insurer, information which may be helpful during a short payoff sale negotiation. This change, which would result in no additional cost to lenders, could be vital to homeowners navigating the real estate transaction process. Further, although the lender is the beneficiary of PMI coverage, the insurance premiums are, in fact, paid by the homebuyer who should have every right to know the name of the company from which mortgage insurance is obtained.

**IV. Other Considerations**

Currently, S. 318 specifies that homeowners who have equity in their property in excess of the *private mortgage insurance ratio* may cancel their PMI coverage. The "private mortgage insurance ratio" is defined as the principle balance outstanding on a residential mortgage equal to less than 80 percent of the property's "original" (sale) value. Given the bill's intent to require automatic cancellation, we understand the use of this valuation standard. However, utilizing the property's sale value as the sole baseline for determining cancellation eligibility fails to take into account any appreciation or devaluation in the market value of the property. Failure to do so will disadvantage both consumers and lenders. Consequently, we would urge the Committee to consider language that would allow lenders to make use of a loan-to-value ratio which uses the home's current **appraised** value in addition to original value.

Under California law, PMI may be canceled by the policyholder when their equity reaches 20 percent of their home's appraised value. Consequently, consumers in California have the benefit of canceling their unnecessary mortgage insurance as soon as market conditions *and* the loan's amortization schedule so warrant. Given the added benefits to consumers, the Committee should consider using a property's appraised value as an additional baseline for determining cancellation eligibility in those cases which are instigated by the borrower. As drafted, servicers could argue that they are not required to, and may be prohibited from, considering the loan-to-market-equity ratio in a cancellation decision. C.A.R. strongly believes that S. 318's language should not intentionally or unintentionally preclude a homeowner's right to cancel based on a property's appraised value.

However, under any "appraised value" option, policies need to be articulated that clarify what constitutes an acceptable set of appraisal conditions including: acceptable limitations on the choice of appraisers, the number of required appraisals, who pays for the appraisals, and the acceptable basis for rejecting an appraisal. In particular, C.A.R. would be concerned if a lender were able to require a borrower to submit or pay for more than one appraisal if done by a licensed/certified appraiser. In addition, given the safeguards that are provided by a national system of licensing for appraisers, we believe it would be inappropriate for a lender to be able to reject an appraisal submitted by a licensed/certified appraiser without explanation and justification.

In addition to a concern for assuring that borrowers be allowed to cancel their PMI as soon as possible, C.A.R. is also concerned that any cancellation provisions not jeopardize the amount of credit available for low-downpayment home purchases. As stated, utilizing a home's purchase price as the baseline for determining cancellation eligibility inherently does not consider market fluctuations. Therefore, under the "sale value" system, if a property's value decreases, it would appear that the qualified homeowner is nonetheless authorized to cancel their mortgage insurance even if their *true* market equity is not 20 percent. C.A.R. is concerned that lenders may be reluctant to make low-downpayment loans if they believe the insurance can be canceled even though the homeowner has not met the minimum equity threshold.

Finally, the use of low-downpayment loans may be at risk if current mortgage insurance premium rates are based on the size of the pool of borrowers. If large numbers of current PMI customers qualify for cancellation under S. 318, a question might be raised as to whether or not their immediate cancellation may lead PMI providers to drastically raise prices for future borrowers. C.A.R. is concerned that

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a sudden and significant surge in mortgage insurance costs could increase the general costs of low-downpayment loans to borrowers, thus threatening the practice altogether. Consequently, we are pleased to see that the legislation recognizes that there do exist situations for which an exemption from the 20 percent general rule might be warranted.

**V. Conclusion**

The California Association of REALTORS® appreciates the opportunity to comment on important issues before the Senate Banking, Housing, and Urban Affairs Committee. C.A.R. urges the Committee to support provisions of S. 318, a bill that would save consumers thousands of dollars in unnecessary insurance premiums. We also strongly urge the addition of a provision to the measure which would require the up-front and annual disclosure of the name of the PMI provider to consumers. These commonsense changes to current law, while requiring only minimum effort by housing lenders, would have an appreciable positive result for consumers and should be adopted.

Thank you again for allowing us this opportunity to testify. If you have any questions concerning this testimony, please contact Marcia Salkin, C.A.R.'s Director of Public Policy, via E-mail at Marcia_Salkin@car.org.

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## STATEMENT OF THE CONSUMER MORTGAGE COALITION ON S. 318, THE HOMEOWNERS PROTECTION ACT OF 1997

FEBRUARY 25, 1997

**Introduction**

Mr. Chairman, the Consumer Mortgage Coalition, a trade association representing national mortgage providers, appreciates the opportunity to submit testimony to you on your bill, S. 318, the Homeowners Protection Act of 1997.

We commend you for taking the initiative in ensuring that America's homeowners' interests are protected. Our industry is committed to working with you in developing a solution that will work for every participant in the mortgage marketplace, including our customers—*consumers*. Initiatives like S. 318 help to ensure that consumers are fully and fairly informed of their rights in mortgage finance. Often, a home purchase is the biggest investment a consumer makes, and great care should be taken throughout the mortgage process to ensure that consumers understand the risks they take, choose mortgage products that are right for them, and incur no unanticipated or unnecessary costs.

Our industry remains committed to expanding housing opportunities by continuing to seek ways to include—rather than exclude—poople of diverse cultures, lifestyles, and backgrounds. By either offering the products ourselves or by partnering with other participants in the mortgage marketplace—originators, private mortgage insurers, Federal and State Government insurance programs, and secondary market participants—we are continuing to design and deliver products that help us expand the markets and customers we hope to serve.

The many preducts produced in mortgage finance today have increasingly evolved into sophisticated financial instruments that have little resemblance to the 30-year, fixed-rate mortgages of yesterday. Variations of the mortgage loan are limited only by the imagination. Affordable housing loan programs, in particular, are producing an endless array of loan products, customized to fit every conceivable need. The homebuyer or mortgagee today is deluged with choices of products, interest rate schedules, loan fees, mortgage insurance, etc. all of which vary from lender to lender and insurer to insurer.

By harnessing technology, the members of the Consumer Mortgage Coalition are particularly adept at customizing their product, to make it more competitive, more efficient, and more liquid. Our growing menu of integrated products and services gives us a unique ability to serve the needs of our customers through varying economic climates. There are no limits for customizing mortgage loans that are to be held in a lender's portfolio; however, there are some restrictions on mortgages that are sold into the secondary market.

The flip side of this creativity and diversity in mortgage products is complexity. Consumers today are faced with a sometimes-confusing array of options that make choosing the right mortgage increasingly difficult. Consumer mortgage disclosures should help borrowers through these decisions. The Consumer Mortgage Coalition is working hard to find ways to make consumer mortgage disclosures more useful so that the consumer can use them as shopping tools in putting together a mortgage package that best fits their personal financial needs.

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The Consumer Mortgage Coalition happens to be in a unique position to submit testimony since its members are collectively involved in every stage of the mortgage transaction—origination, servicing, insurance and reinsurance, selling, and investing. S. 318 touches on each of these activities, as follows:

*Origination.* Any disclosures relating to mortgage insurance (MI) will generally be provided in conjunction with the other disclosures presented to consumers when an application for a loan is received and/or the loan is closed at settlement.

*Servicing.* Any notices provided to consumers regarding MI after a loan is closed is the responsibility of the servicer. Servicers may be the company that originated a mortgage, but can also be firms that specialize in handling the ministerial details of a mortgage on behalf of the investor in the loan or in securities backed by it. Servicers are generally the repository for all of the loan documents (mostly still in paper form) associated with individual mortgage loans. Servicers, acting as conduits between the lender and the investor, make sure the borrower pays his or her loan and meets any other conditions applicable to the loan.

*Insurance.* Mortgage insurance (MI) protects lenders or investors in mortgages in the case of borrower defaults. Mortgage insurance is supplied by both the private sector (PMI's) and the public sector (FHA/VA). PMI generally covers the top 20 to 30 percent of the loan amount, is available on a wide variety of loan products, and is not restricted to preset loan limits.

For first-time, low- to moderate-income homebuyers, the greatest barrier to homeownership is the downpayment. Mortgage insurance opens up housing opportunities for many potential homebuyers, allowing them to purchase a home with a small downpayment and enabling them to become homeowners many years sooner.

Reinsurance is simply insurance that reinsures primary insurers against a specified threshold risk of loss.

*Selling.* The majority of mortgages are sold into what is known as the "secondary market" after origination. Investors have many different demands, but most want the added safeguard of mortgage insurance to protect them from losses when borrowers default. This market is dominated by two federally-chartered agencies and one Federal agency—Fannie Mae, Freddie Mac, and Ginnie Mae.

With the creation of the standard mortgage-backed security (MBS), the private mortgage market was able to formalize and standardize many of its mortgage purchase programs and effectively serve the non-agency market. These nonconforming jumbo mortgages (loans above the Fannie Mae and Freddie Mac loan limits) are sold to mortgage conduits that then issue mortgage-backed securities. The mortgage conduits purchase mortgage insurance from an issuer of mortgage insurance policies. Mortgage insurance provides credit enhancement to the pool of loans so that the mortgage-backed securities issued by the conduit receive an investment-grade rating from the rating agencies.

In addition, most State and local housing authorities that issue tax-exempt bonds, and loan the proceeds to low-income homebuyers, are required to obtain mortgage insurance from private mortgage insurers as a condition of obtaining an investment-grade rating on the tax-exempt bonds.

*Investing.* Almost half of the mortgage-backed securities sold into the secondary market are purchased by banks, thrifts, and other companies active in mortgage loan origination. The remainder are purchased by pension funds and other institutional investors, individual investors, and also by Fannie Mae and Freddie Mac. Investors purchase these securities to achieve greater portfolio diversification and because enhancements, such as those provided by Fannie Mae, Freddie Mac, and Ginnie Mae, as well as private credit enhancements and mortgage insurance protection give these investors the layers of protection they are seeking in their portfolios.

As noted above, the Consumer Mortgage Coalition supports the goals of S. 318: (1) to ensure that consumers receive full disclosure with respect to the consumer's rights under the MI policy when the mortgage is originated, and (2) to ensure that consumers pay mortgage insurance (MI) premiums for only the period for which they have contracted and for which MI is genuinely necessary to protect lenders and investors in mortgage-backed securities. The Consumer Mortgage Coalition also believes that the goal of any piece of legislation should be to enhance, not impair, the free flow of capital into the mortgage market.

Sharing the Committee's concerns, individual participants in the industry are already working with secondary market investors in order to develop a sound policy with respect to MI that is simple for consumers to understand and easy for servicers to administer. We would urge that the private market be allowed to develop guidelines on disclosure and cancellation of MI that take into consideration the many factors involved in the disclosure and cancellation process.

If the Committee decides to proceed with legislation, however, there are several sections of S. 318 that raise concerns. While a number of these issues may simply

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result from drafting ambiguities, we would like to bring them to the Committee's attention and suggest ways to resolve these concerns.

1. *Coverage Ratio*

The legislation generally prohibits lenders from requiring that consumers obtain mortgage insurance when loan-to-value (LTV) ratios are 80 percent or less at the time of loan origination. The bill does, however, give the Federal Reserve authority to exempt classes of mortgages from this requirement.

As noted above, the mortgage market has now created a wide range of products that meet very different customer needs. Mortgage insurance has been similarly innovative, and together lenders, insurers, and investors have put many Americans who would not have otherwise qualified to buy a house into a home of their own. Sometimes, MI is important to protect a lender or encourage secondary market participation in a loan product even if the downpayment is 20 percent or more. We would urge the Committee not to prohibit MI coverage in such cases, as this could inadvertently result in denying mortgage credit to borrowers who qualify in whole or in part because MI can be obtained. We believe disclosures given to consumers at closing will ensure that only those borrowers who need MI pay for it.

2. *Automatic Cancellation*

It is our understanding that the bill might ultimately be changed to require that MI be canceled by a lender or investor, with a servicer acting on their behalf, when a LTV declines below 80 percent.

Mortgage insurance companies, like mortgage originators, today offer a very wide variety of different preducts. All mortgage insurance products are not cancelable even if LTV's decline. In fact, a number of consumers select noncancelable MI over cancelable coverage because of lower up-front premium costs. An 80 percent cancellation requirement does not meet the needs of the investor community for many loans, but particularly for those loans serving the "affordable" housing market.

If the 80 percent LTV cancellation requirement were to be applied retroactively, the terms of many existing MI policies establishing the contractual expectations between the MI issuer, the lender, and investor would be impaired and the secondary market would be disrupted. Such disruptions would discourage ongoing investment in the secondary market and could ultimately result in higher interest rates on mortgage loans and lock out most of the consumers served by "affordable" mortgage products.

Furthermore, a retroactive application of the 80 percent LTV cancellation requirement would impair a number of existing MI policies which by their terms are noncancelable or can only be canceled if the LTV falls below 75 percent or 70 percent or other lesser levels negotiated by the lender and the consumer. Impairment of the contractual terms of those policies could well prove to be unconstitutional.

In addition to disrupting the secondary market, imposing retroactive application of the 80 percent LTV cancellation rule would impose an enormous burden on servicers who maintain most of the information related to individual mortgage loans in paper form. To determine the "private mortgage insurance ratio" required by the legislation, servicers would be required to retrieve the original appraised value of mortgaged properties from millions of paper files, input that information into their data systems, and would have to test and to verify the information before sending notice to consumers. While the legislation would permit the servicers to seek reimbursement of this cost from the MI industry, the MI issuers in turn could pass that cost on to future purchasers of MI in the form of higher premiums. We would also note that the ability of servicers to seek reimbursement of these costs from the MI companies could subject the MI companies and the servicers to potential RESPA violations.

We believe that sending a generic disclosure to existing mortgagees advising these consumers of their rights to potentially cancel their mortgage insurance and receive assistance from servicers in doing so will more than ensure that consumers' rights are protected. If the disclosures are simple, straightforward, and included in an annual escrow notice, for example, the costs associated with those disclosures, after initial system start-up costs, would be deminimus.

Permitting MI cancellation based on a LTV calculated off of the original appraisal of the home would impose an additional risk on the lender and/or investor, a risk for which they may well require offsetting compensation in the form of a higher interest rate on the loan. Had cancellation been based on the original appraised value during the economic downturn in the energy States in the mid-1980's and during the regional economic declines in California and had cancellation been required at the 80 percent LTV ratio as the bill appears to require, MI coverage on a number of loans in those regions might well have been canceled at the exact time the cur-

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rent value of their homes was decreasing dramatically. Lenders and investors require MI to protect themselves in those situations and they only obtain protection from risk of a downturn in the market if cancellation is measured off of the current appraised value of a home. Should a consumer decide to exercise his or her right of cancellation, the consumer should be required to provide a *current* appraisal of the mortgage property.

3. *Disclosures*

The legislation would require that a disclosure regarding a consumer's right to cancel MI be provided at closing and from time to time throughout the life of a loan. We recommend the following clarifications to the notice requirement be included in the legislation:

- Notices relating to MI cancellation rights, whether delivered at closing or on a periodic basis, should be uniform on a nationwide basis, containing information necessary to inform the consumer that MI can, in some cases, be canceled. The Federal Reserve should issue regulations that would nationally and uniformly prescribe the format of this disclosure.
- If servicers are required to provide disclosure regarding potential MI cancellation rights, those notices should be generic in form and be sent no more often than annually with other statements already being sent to consumers.

4. *Liability*

The legislation is not clear as to the liability that would be assumed by the originators of the loans or by the parties servicing the loans. Under the legislation, loan originators would be required to provide origination disclosures regarding MI cancellation rights. The failure to provide such disclosure or the provision of inaccurate disclosure, however, may have no practical impact on borrowers actually canceling MI at the appropriate time and under the appropriate conditions. With respect to servicers, they would be obligated under the legislation to give periodic disclosures and then to work with the consumers and MI carriers to process the MI cancellation at the appropriate time. Again, the failure by the loan servicers to provide a timely or accurate periodic disclosure regarding the borrower's MI cancellation rights may not have any negative impact on the borrowers actually canceling their MI coverage.

Separately, loan servicers may have liability to investors if the loan servicers incorrectly cancel a MI policy in an attempt to comply with the legislation. This latter liability could be considerable, particularly if there are losses to the investor that would have been covered by the incorrectly canceled MI policy.

The legislation proposes an interconnected web of liability which involves consumers, originators, servicers, and investors. In addition, the disclosure obligations are distinct from the obligation to timely and accurately cancel MI coverage. In this context, the Consumer Mortgage Coalition recommends the following:

- With respect to consumer claims, we recommend that originator and servicer liability be limited to actual damages caused by practices that defeat or delay the borrower's right to cancel MI coverage on a timely basis and in compliance with the consumer's contractual obligations.
- With respect to potential servicer liability to investors, we recommend servicers have no liability to investors for an inaccurate or premature cancellation of MI coverage if the servicer acted in good faith to comply with the MI cancellation requirements contained in the legislation and the servicer maintains procedures reasonably adapted to avoid MI cancellation errors.

Establishing a liability "safe harbor" for originators and servicers will promote the underlying purposes of the legislation.

5. *Retroactivity*

As noted above, applying the provisions of the legislation to existing loan portfolios raises numerous implementation and compliance problems, and may disrupt the secondary market. As a result, we recommend that the automatic cancellation requirements, if enacted, be imposed only for loans originated after the effective date of the legislation. The generic notice of the right to cancel requirement, however, can and should apply to all loans to ensure that consumers with pre-existing loans are adequately informed of their potential right to cancel their MI policy.

6. *Effective Date*

Reconfiguring loan origination and servicing processes will bo a complicated task for the mortgage industry. As a result, we urge that the effective date of S. 318 be no sooner than 180 days after enactment or 90 days after the date on which the

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Federal Reserve issues final regulations setting forth disclosure standards, whichever is later.

**Summary**

In summary, the Consumer Mortgage Coalition recommends:

- That individual participants in the mortgage industry be permitted to continue their individual coordination with the secondary market investors to develop policy guidelines related to MI disclosure and cancellation before a legislative remedy is undertaken. If policy guidelines fail to be developed that are acceptable to the Committee, the Committee could proceed to consider S. 318.
- If the Committee determines to proceed with consideration of S. 318;
  - The Consumer Mortgage Coalition supports providing existing mortgagees with a generic disclosure notice advising consumers of their potential MI cancellation rights. These notices should be mailed with other annual statements already being sent to mortgagees. The Federal Reserve should issue regulations establishing the parameters of a generic disclosure that should be uniform and implemented on a nationwide basis.
  - On a prospective basis, the Consumer Mortgage Coalition supports a requirement that a consumer purchasing MI is entitled to disclosure at closing and on a periodic basis thereafter that is sufficient to inform consumers of their MI cancellation rights. The Federal Reserve should issue regulations establishing the parameters of a generic disclosure that should be uniformly implemented on a nationwide basis.
  - The Consumer Mortgage Coalition supports the consumers' existing right to cancel their MI when they have purchased cancelable MI policies once a lender-approved appraisal is provided by the consumer.
  - The Consumer Mortgage Coalition supports legislation that recognizes the ministerial role the servicer plays and limits liability accordingly.
- That the Committee coordinate with the participants in the mortgage industry, including the secondary market, to ensure that any legislation achieves a proper balance between the needs of the consumers to be adequately advised of their MI cancellation rights and the needs of the mortgage industry to assure that MI remains a viable tool for enhancing efficiencies in the mortgage marketplace by permitting the development of mortgage products which satisfy investor demand in the secondary market while encouraging homeownership.

The Consumer Mortgage Coalition looks forward to working with the Committee in developing a solution that does not impair the free flow of capital into the mortgage market, that works for our customers—*consumers*—and our industry.

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## MICA NEWS RELEASE

## MORTGAGE INSURANCE INDUSTRY SUPPORTS DISCLOSURE TO CONSUMERS OF THEIR CANCELLATION RIGHTS

FOR RELEASE AT 10 A.M. EST MARCH 25, 1997

**WASHINGTON, D.C.**—The private mortgage insurance industry supports full disclosure of consumers' rights to request cancellation of their insurance, the industry's trade group testified today.

"We support legislation that provides a framework for informing consumers of their opportunities to have their mortgage insurance canceled," said Mortgage Guaranty Insurance Corp. Chairman William H. Lacy.

Lacy testified for the Mortgage Insurance Companies of America before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, which is considering a mortgage insurance proposal offered by Senator Alfonse D'Amato, R–N.Y.

"The industry also supports a new mortgage insurance cancellation policy announced today by Fannie Mae, one of the largest investors in mortgages," Lacy said.

The industry endorsed informing borrowers when mortgages are originated that their loans are covered by insurance, as well as notifying them annually of their cancellation rights. "This information could be added to the lender's annual statement to the borrower," Lacy said.

Lacy cautioned against legislation that would add unnecessary costs to the homebuying process or establish rigid rules that would not work in a rapidly changing marketplace.

"We enjoy the most efficient mortgage market in the world," he said. "Working together, we can keep it that way."

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Mortgage insurance enables families to buy a home with as little as a 3 to 5 percent downpayment. It protects lenders and investors from loss if a borrower does not make payments, and they generally require it on loans with less than a 20 percent downpayment.

"Over the past 40 years, the mortgage insurance industry has enabled 17 million families to become homeowners," Lacy said.

Lacy noted that the mortgage insurance company plays no role in any decision to cancel insurance. That decision is at the discretion of the lender or investor in the loan.

"That's the way it should be," he said. "Otherwise, we might disrupt the flow of funds available for affordable low-downpayment mortgages."

Lacy added that while the insurer's relationship is with the lender, the insurer shares a common interest with the borrower.

"We want to be sure that the home the consumer buys is one he can afford now and for years to come," he said. "Why? Because if the borrower doesn't pay, we pay!"

"The Nation's homeownership rate is nearly 66 percent," Lacy said. "My industry is proud to have played a key role in that accomplishment."

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## STATEMENT OF JORDAN CLARK

PRESIDENT, UNITED HOMEOWNERS ASSOCIATION

FEBRUARY 24, 1997

Mr. Chairman and Members of the Committee, the "Homeowners Protection Act of 1997," S. 318, is a welcome and necessary step in preventing present and future homeowners from paying for private mortgage insurance (PMI) when it is no longer necessary.

The United Homeowners Association (UHA) is a nationwide, consumer organization, which in promoting and preserving homeownership represents the interests of America's 65 million homeowners.

I will preface my remarks by stating that we understand and appreciate the fact that PMI plays an important role in providing financing for many homeowners. By protecting the investment of the lender and secondary market during the early stages of the loan, the housing finance industry through PMI is more willing to originate loans to those who do not have a 20 percent downpayment.

It is probably safe to say that without PMI millions of families and individuals would have had a delayed, if not stalled, entry into the world of homeownership.

The justification for PMI is based on risk assessment by the housing finance industry. By practice over the last few decades, lenders and the secondary market have required PMI when borrowers have less than a 20 percent equity value in their home. If the comfort level for the industry has been 20 percent, it stands to reason that PMI (absent unusual circumstances) is not necessary for risk management and prudent underwriting procedures once the homeowner has reached the 20 percent equity mark.

Unfortunately, too many in the lending community have extended PMI coverage beyond the 20 percent level, and have taken advantage of the homeowners ignorance and/or nebulous private and public sector procedures regarding PMI. In essence, converting a risk management program to a profit center at the cost of the unwitting homeowner.

The real estate finance community should not be allowed to have it both ways. If they are protecting their risk by mandating PMI, once the risk has been satisfied at 20 percent equity, PMI should no longer be necessary and the policy should be terminated.

The major problem with PMI today is the fact that homeowners who are forced to obtain the insurance are at the mercy of their servicer and/or lender when it comes to canceling the PMI once the so called 20 percent equity has been reached.

First, we can assume that most homeowners are not aware of the fact that PMI should not be mandatory after they have reached 20 percent equity. Second, if they are aware, they may face a battle with their servicer or lender when it comes to canceling PMI since loan documents are very clear on when it is needed, but not on when it is no longer necessary.

S. 318 addresses the problems of cancellation and notification and proposes solutions which are fair to both consumer and lender. Under S. 318, except when the Federal Reserve Board grants exceptions, the homeowner has a right to cancel the PMI once 20 percent equity has been reached. Just as important, without cost to

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them, present and future homeowners who have PMI have to be notified of their right to cancel.

We anticipate that some in the industry will make the argument that it is going to be too costly to the industry to implement the legislation, especially for existing homeowners.

No doubt some costs will be involved. For those mortgagees originating after passage, the cost to the industry should be minuscule since the mortgage insurance ratio can easily be determined from closing documents and notification can be accomplished in a monthly or annual statement which the homeowner will receive.

The greatest cost to the industry will no doubt be for determining the "current private mortgage insurance ratio" for those who already have PMI. In addition, the "reimbursement" costs from the PMI issuer to the servicer for complying with the legislation will produce more questions than answers in addition to heated debate in the industry.

No matter the objections to the legislation based on costs of implementation, the cost to the homeowner for unnecessary insurance is far greater and outweighs the costs to the industry.

However, recognizing that the legislation does impose mandates on already existing and future loan documents which will produce many legitimate reactions and questions, we suggest that the Committee review State legislation which addresses the issue, if it has not already done so. California has had a disclosure statute in effect since 1992. New York already prohibits continuation of PMI after a 25 percent equity is reached, and Minnesota addressed the issue in 1994.

In addition, Fannie Mae's recent draft announcement on cancellation of PMI with detailed requirements addressing both borrower-initiated and automatic cancellation appears to be an equitable approach to the problem.

As any legislation with consumer and industry repercussions, the PMI issue will produce conflicting debate. We hope that the Committee will continue the legislative process in solving the problem so that present and future homeowners will not have to carry PMI which is no longer necessary.

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## STATEMENT OF SAIYID T. NAQVI

PRESIDENT AND CEO, PNC MORTGAGE CORPORATION OF AMERICA

MARCH 3, 1997

PNC Mortgage Corporation of America is pleased to provide written testimony on the Homeowners Protection Act of 1997 (S. 318). PNC Mortgage Corp., a subsidiary of PNC Bank Corporation, is a major retail originator of residential mortgage loans. PNC Bank Corp. is one of the Nation's largest banking organizations with total assets of over $73 billion offering broadly diversified financial services.

The bill addresses a major problem for many consumers who are not informed of their right to cancel their private mortgage insurance policy. This bill is designed primarily to ensure that consumers have this information and are not unreasonably deterred from exercising their rights.

We support the general intent of S. 318 to provide consumers notification of their rights to cancel private mortgage insurance. For some time now, we have given notice to our borrowers at closing and also notify borrowers of their right to cancel when their loan amortizes to a loan-to-value ratio at which our investors allow for cancellation.

We are concerned, however, that the bill as drafted does not take into consideration issues such as declining property values and loans either in default or with a history of late payments. The suggested changes below address these issues and remove requirements placing administrative burdens on the lender without a corresponding benefit to the consumer. Please also note that the conditions for the cancellation of mortgage insurance are not the invention of lenders, but are based on the requirements of secondary market investors.

- The bill requires notice from the time the loan closes until PMI is canceled or the loan is paid off. There is no reason to give the borrower a notice after closing until the loan amortizes to a level where the PMI can potentially be canceled. In fact, to do so will likely confuse the borrower and cause fruitless inquiries and requests. For instance, a borrower who obtains a loan with a 95 percent loan-to-value ratio, and an interest rate of 8 percent, will not have his/her loan amortize to 80 percent until just before the 12th year of a 30-year loan term.
- The bill would require lenders who send monthly statements to give the disclosure every month. We would recommend that the disclosure be given with the annual

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escrow statement, starting with the annual escrow statement issued in the first year after the borrower's loan amortizes to the loan-to-value level where it is eligible for PMI cancellation under the investor's guidelines. The RESPA required annual escrow statement details the monthly escrow amounts that the borrower will be charged for the next 12 months. This seems the appropriate time to advise the borrower of their right to cancel PMI.

- Some private investors do not currently allow PMI to be canceled until the loan reaches a 75 percent loan-to-value, subject to any State law restrictions. This bill should not affect those loans on a retroactive basis. The risk to the investor is reduced at the 80 percent level but not eliminated. Furthermore, some State bond programs designed for low- to moderate-income borrowers do not allow for the cancellation of mortgage insurance.
- The bill should allow for some restrictions on the borrower's ability to cancel the PMI where there is still risk to the lender. **First**, we would recommend that the borrower must be current on the loan and not have a history of late payments. Delinquent borrowers are more likely to go into foreclosure triggering a potential recovery on the mortgage insurance policy. The purpose of the bill should be to help borrowers who pay on a timely basis where the risk of default is thus minimized. **Second**, the bill needs to account for decreases in property value so that the loan-to-value at cancellation is not in fact higher than allowed. Over the past few years, we have seen fluctuations in property values across the country, particularly in Texas, California, New York, New Jersey, and Massachusetts. Other areas have also seen declines. Lenders have experienced some borrowers trying to unload their properties on the lender when they perceive their equity has been reduced or eliminated. Having the PMI still in place is critical if the actual loan-to-value has not reached the level for cancellation because of property value declines. Given this issue, the lender should not disclose the loan-to-value ratio since it may not be accurate. **Third**, any requirement to cancel the PMI at a certain loan-to-value level should be based on actual principal payments made on the loan whether through monthly payments or early principal payments. Property values have risen dramatically in many markets such as New York and California only to plummet later. The risk of loss to the investor is really reduced when the borrower has actually invested money in the property, not just because the value of the property has risen based on other sales in the marketplace. This view is consistent with the practice of not requiring PMI when the downpayment is at least 20 percent. **Fourth**, these requirements should only apply to private mortgage insurance for loans secured by owner-occupied properties. There is a higher risk of default on non-owner-occupied properties. At a minimum, the standards for cancellation should be greater.
- The bill language that says a customer is not required to "maintain" PMI if they have 20 percent equity should be revised to say the customer has a right to cancel if the requirements for cancellation are met. The current language implies automatic cancellation, regardless of property value declines or loan delinquency default or payment.
- Clarify that the lender may require the borrower to pay for an appraisal of the property to ascertain actual loan-to-value. This is necessary to address whether the property has maintained its original value. In addition, it should be clear that the amount of the appraisal is not an amount that must be disclosed as part of the loan origination on the Truth-in-Lending statement or on the Good Faith Estimate. Otherwise, it is likely that class action lawyers will bring actions asserting that it is required to be disclosed costing the industry unnecessary legal costs. The PMI disclosure at origination could disclose that an appraisal may be required in order to cancel the insurance.
- At the time of application, the lender may not know who the investor will be and so it is impossible to give an accurate disclosure at that time of what the requirements will be for cancellation. As a result, we recommend that the bill be modified to clarify that the up-front disclosure is to be given at closing. Please also note that investors typically reserve the right to change the requirements given market risks, thus a lender would not know what requirements will be in place at the time of the request to cancel.
- The definition for private mortgage insurance ratio is unclear and does not seem to work as drafted. We would suggest changing the term to "equity to loan ratio." Equity should be defined as the percentage of money that is paid by the borrower either through downpayment or through principal payments. The terminology on page 2, lines 14–16 could instead read "... if that consumer has an equity to loan ratio that is equal to or greater than the ratio the investor requires."
- In order to avoid confusion and conflicting requirements, the statute should preexempt State law requirements or restrictions.

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Again, we commend you for your efforts to aid consumers in eliminating the payment for PMI when it is no longer required. We also appreciate the opportunity to provide this testimony. If we can provide any additional information on our views or this testimony, please feel free to contact us.

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## STATEMENT OF THE CONSUMER BANKERS ASSOCIATION ON S. 318, THE HOMEOWNERS PROTECTION ACT OF 1997

MARCH 3, 1997

The Consumer Bankers Association[1] (CBA) is pleased to submit these comments for inclusion in the record of the Committee on Banking, Housing, and Urban Affairs hearing on S. 318, the "Homeowners Protection Act of 1997," which was held on February 25, 1997.

At the outset, we appreciate and share your recognition that private mortgage insurance (PMI) serves a valuable purpose in the residential mortgage markets. It provides a significant measure of protection for mortgage lenders and investors—particularly secondary market investors—without which mortgages would be more difficult or impossible for some consumers to obtain. The value of PMI as a catalyst for mortgage lending at all income levels should be kept in mind throughout Congress' consideration of S. 318.

We also share your concern that consumers ought not be burdened with the expense of PMI when they have sufficient equity in their homes to make that insurance unnecessary, if it can be reasonably determined when that point is reached. We also agree that it would be appropriate for consumers to be informed about the process for terminating PMI coverage when it is no longer required, as long as the notice requirement is not unduly burdensome.

We therefore support the goals of S. 318: disclosure to consumers about PMI, and ground rules for determining when it is cancelable. There is already momentum in this direction, in the form of legislation in some States and pending guidelines from the major secondary market holders of residential mortgages (FNMA and FHLMC). Your bill, S. 318, provides an opportunity to synthesize these various approaches and preduce uniform national standards for the treatment of PMI. That, we believe, is a worthwhile endeavor.

There are, however, some aspects of the bill as drafted that need further attention, clarification, or modification:

1. **Prospective application.** If a mandatory PMI ratio is to be set by Federal law, the legislation should apply the new ratio only prospectively, that is, to mortgages written after enactment. Perhaps that is the intent of S. 318 as proposed, but the bill (in particular Section 126(f)(2)) seems ambiguous as to its effect on existing mortgages. It would be inappropriate and intrusive (and possibly unconstitutional) to modify the terms of existing mortgage contracts retroactively. The disruptions of reviewing and re-writing existing mortgage portfolios would generate costs and uncertainties beyond any return benefit to consumers.

2. **Variations from 80–20 formula.** A universal and absolute 80–20 formula for PMI coverage would almost certainly prove unworkable in some circumstances. For example, private or publicly supported mortgage programs that are targeted to first-time homebuyers may need a different ratio in some cases to meet underwriting standards. The immense variety of mortgage products in the market is itself testimony to the lending industry's efforts to respond to housing (and mortgage) demand from all economic levels in our society. Thus, even if 80–20 is the proper benchmark for general purposes, the law should allow variations in the ratio where circumstances justify it.

3. **Conditions for PMI cancellation.** As proposed in the bill, consumers would be entitled to cancel PMI whenever the balance owing drops below 80 percent of the value of the property *at closing*. While this may be an appropriate general objective, it should not be an ironclad rule. For example:

(a) If the property value declines over time, the balance owing may exceed 80 percent of *current* value even though it's less than 80 percent of the original value.

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[1] The Consumer Bankers Association is the recognized voice on retail banking issues in the Nation's capital. Member institutions are the leaders in consumer, auto, home equity, and education finance, bank sales of investment products, small business services, and community development. Founded in 1919, CBA's members hold more than 900 bank and thrift charters with total assets of more than $2.9 trillion.

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It could jeopardize the integrity of the loan and create safety and soundness problems to force cancellation of PMI in that situation.

(b) Conversely, the property might appreciate significantly in value, so the consumer's equity in fact exceeds 20 percent of current value even though the balance owing is still more than 80 percent of the original value. In this circumstance, an ironclad ratio tied to original value would prevent the consumer from taking advantage of that appreciation.

(c) Even where a consumer has reduced the balance owing below 80 percent of value, there may be circumstances that justify continuation of PMI coverage: a pattern of late or irregular payments, or an adverse change in the mortgagor's financial circumstances.

To deal with these variables, we believe any legislation should allow creditors or servicers to set reasonable conditions for the cancellation of PMI. These might include: (i) requiring the consumer to provide a current written appraisal of the property's value from an appraiser acceptable to the lender or servicer, (ii) requiring a pattern of payment by the consumer that does not include delinquency or default, or (iii) establishing the existence of satisfactory current credit-report information on the consumer.

4. **National standards for PMI disclosure and cancellation.** Any new Federal requirements about PMI, such as those proposed in S. 318 to be incorporated in the Truth-in-Lending Act, should be precise and standardized, with model disclosures approved by the Federal Reserve Board as a safe harbor against potential civil litigation (including class actions). The disclosure and cancellation rules should set a uniform national standard for dealing with PMI, and so should displace or preempt any State law on the same subject. Our industry knows only too well the compliance risks that follow from vague or imprecise Federal credit laws, and from the overlay of State and Federal laws on the same transactional details.

5. **Retroactive disclosure unworkable.** In particular, the disclosure called for in proposed TILA Section 126(f)(1) is unworkable, and an unfair and unnecessary burden on mortgage lenders. As written, it would require banks and other mortgage originators to send a notice to every prior customer whose mortgage included PMI. This would mean digging out file information from years—or decades—ago, *if* the creditor even retained such archival records. The original loan documents will likely have been transferred to other holders. The original creditor may have no way to know current customer addresses, payment histories, or other information relevant to account status and PMI coverage. We urge elimination of this subsection. For existing mortgages, the disclosure called for in proposed Section 126(f)(2)—from the current servicer—is more than adequate to alert the consumer of possible PMI cancellation rights.

6. **Periodic statement disclosures.** The proposed Sections 126(d) and 126(f)(2) would require servicers to send PMI disclosures with "each written statement of account." There is currently no uniform requirement or practice with respect to periodic statements in mortgage transactions. This rule would therefore burden those servicers or holders who voluntarily provide more frequent statements, while putting a lesser burden on servicers who send only occasional statements. Frankly, in many cases, it would inundate the consumer with more PMI disclosures than could possibly be helpful. We strongly urge that one PMI disclosure per year (which may be included with a periodic statement) should be sufficient.

7. **Effective date.** A 90-day period for transition (as provided in the proposed Section 126(h)) is far too short a period for the regulation-writing, re-programming, re-training, and printing needed to implement this bill. We urge adoption of the device used for other Federal credit laws: the new act becomes effective a specified time (e.g., 180 days after promulgation of Federal Reserve Board regulations implementing the act). This assures that the regulatory rules are in place before creditors and servicers must establish compliance procedures.

8. **Civil liability.** The bill, S. 318, would enact a new Section 126, to be located in Chapter 2 of the Truth-in-Lending Act. By virtue of that location, compliance with Section 126 would be subject to the civil penalty provisions of Section 130 of the TILA. But we question whether those liability provisions are necessarily appropriate for the disclosures and other conduct called for in Section 126. For one thing, Section 130 imposes liability on a "creditor," a defined term that would not include servicers that have significant responsibilities under the new Section 126. More importantly, Section 130 contemplates not only the *actual* damages but also statutory damages (up to $1,000 per violation) and class action aggregations of those damages. We do not believe this range and level of near-punitive sanctions are appropriate for a provision like Section 126 which imposes not only disclosure duties but contract limitations as well. Actual damages are sufficient.

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**9. Other technical/drafting matters:**

(a) Proposed Section 126(a)(2) should confirm that the Federal Reserve Board is to provide model disclosures.

(b) Proposed Section 126(b) requires disclosure of a "*current* private mortgage insurance ratio," but gives no indication of what this means or how it relates to the definition in Section 126(g)(3) which fixes the "private mortgage insurance ratio" at 80–20. If the "current" ratio is meant to reflect some different figure, this provision needs clarification. Also, the caption to Section 126(b) does not match its contents.

(c) The bill uses inconsistent terminology to refer to the time the mortgage is made. Section 126(a)(1) refers to the time when the "transaction is consummated," while Sections 126(b) and 126(g)(3) refer to when the transaction is "enterod into." If this new section is to be integrated into the Truth-in-Lending Act, "consummation" is the proper benchmark.

In summary, we support the goals of S. 318. We believe the bill needs refinement (1) to permit reasonable exceptions from an ironclad 80–20 ratio and mandatory cancellation of PMI at that point, (2) to narrow and focus the disclosures, (3) to assure this bill sets national standards by preempting different State rules on PMI, and (4) to adjust the effective date and civil liability implications. We will be happy to work with Committee Members and staff on appropriate legislative language.

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II

105TH CONGRESS
1ST SESSION

# S. 318

To amend the Truth in Lending Act to require automatic cancellation and notice of cancellation rights with respect to private mortgage insurance which is required by a creditor as a condition for entering into a residential mortgage transaction, and for other purposes.

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IN THE SENATE OF THE UNITED STATES

FEBRUARY 12, 1997

Mr. D'AMATO introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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# A BILL

To amend the Truth in Lending Act to require automatic cancellation and notice of cancellation rights with respect to private mortgage insurance which is required by a creditor as a condition for entering into a residential mortgage transaction, and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

**SECTION 1. SHORT TITLE.**

This Act may be cited as the "Homeowners Protection Act of 1997".

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**SEC. 2. NOTIFICATION OF CANCELLATION RIGHTS FOR PRIVATE MORTGAGE INSURANCE.**

(a) IN GENERAL.—Chapter 2 of the Truth in Lending Act (15 U.S.C. 1631 et seq.) is amended by inserting after section 125 the following:

**"SEC. 126. CANCELLATION RIGHTS FOR PRIVATE MORTGAGE INSURANCE.**

"(a) INSURANCE RATIO STANDARD.—

"(1) IN GENERAL.—No consumer, in connection with a residential mortgage transaction, shall be required by the creditor to obtain or maintain private mortgage insurance if that consumer has, or will have at the time that the transaction is consummated, equity in the property that is the subject of the transaction in excess of the private mortgage insurance ratio.

"(2) REGULATORY REQUIREMENT.—The Board—

"(A) shall issue rules to implement paragraph (1); and

"(B) may issue rules exempting certain classes of transactions from the provisions of paragraph (1) if the Board finds that such exemption is necessary—

"(i) to ensure sound underwriting standards; or



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"(ii) to further the availability of credit to persons who might otherwise be denied credit if paragraph (1) was applied to residential mortgage transactions involving such persons.

"(b) NOTICE OF RIGHT OR LACK OF RIGHT TO CANCEL.—If a consumer is required to obtain and maintain private mortgage insurance as a condition for entering into a residential mortgage transaction, the creditor shall disclose to the consumer the current private mortgage insurance ratio for the subject property, in writing, at the time that the transaction is entered into.

"(c) INFORMATION REQUIRED TO BE DISCLOSED.—With respect to each residential mortgage transaction, the creditor shall disclose to the consumer, in writing, the following information at the time the transaction is entered into:

"(1) IDENTIFYING INFORMATION.—Such information as may be necessary to permit the consumer to communicate with the creditor or any subsequent servicer of the mortgage, concerning the private mortgage insurance of that consumer.

"(2) CANCELLATION PROCEDURES.—The procedures required to be followed by the consumer in canceling the private mortgage insurance.



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"(d) INFORMATION REQUIRED TO BE DISCLOSED WITH EACH PERIODIC STATEMENT.—If a consumer is required to obtain and maintain private mortgage insurance as a condition for entering into a residential mortgage transaction, the person servicing the mortgage shall include in or with each written statement of account provided to the consumer, beginning with the first such statement following the date of enactment of the Homeowners Protection Act of 1997, while such insurance is in effect, but not less than annually—

"(1) the information required to be disclosed under subsections (b) and (c); or

"(2) a clear and conspicuous written statement containing—

"(A) a statement that the consumer may cancel the private mortgage insurance and a description of the circumstances under which such a cancellation may be made; and

"(B) an address and telephone number that the consumer may use to contact the creditor or the person servicing the mortgage.

"(e) NOTICES FURNISHED WITHOUT COST TO THE CONSUMER.—



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"(1) IN GENERAL.—No fee or other cost may be imposed on any consumer with respect to the provision of any notice or information to the consumer pursuant to this section.

"(2) REIMBURSEMENT.—A creditor or subsequent servicer of the mortgage may seek reimbursement from the issuer of the private mortgage insurance, with respect to any cost incurred by that creditor or subsequent servicer in providing any notice or information to the consumer pursuant to this section.

"(f) EXISTING MORTGAGES.—If a consumer was required to obtain and maintain private mortgage insurance as a condition for entering into a residential mortgage transaction occurring before the date of enactment of the Homeowners Protection Act of 1997—

"(1) not later than 180 days after that date of enactment, the creditor shall disclose, in writing, to each such consumer—

"(A) the information described in paragraphs (1) and (2) of subsection (c); and

"(B) that the private mortgage insurance may, under certain circumstances, be canceled by the consumer at any time while the mortgage is outstanding; and



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"(2) the person servicing the mortgage shall include in or with each written statement of account provided to the consumer, beginning with the first such statement following the date of enactment of that Act, while such insurance is in effect, but not less than annually—

"(A) the information required to be disclosed under subsection (c); or

"(B) a clear and conspicuous written statement containing—

"(i) a statement that the consumer may be able to cancel the private mortgage insurance (if such is the case); and

"(ii) an address and telephone number that the consumer may use to contact the creditor or the person servicing the mortgage to determine whether the consumer has the right to cancel the private mortgage insurance and, if so, the conditions and procedures for canceling such insurance.

"(g) DEFINITIONS.—In this section, the following definitions shall apply:

"(1) MORTGAGE INSURANCE.—The term 'mortgage insurance' means insurance, including any



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mortgage guaranty insurance, against the nonpayment of, or default on, a mortgage or loan involved in a residential mortgage transaction.

"(2) PRIVATE MORTGAGE INSURANCE.—The term 'private mortgage insurance' means mortgage insurance other than mortgage insurance made available under the National Housing Act, title 38 of the United States Code, or title V of the Housing Act of 1949.

"(3) PRIVATE MORTGAGE INSURANCE RATIO.—The term 'private mortgage insurance ratio' means a principal balance outstanding on a residential mortgage equal to less than 80 percent of the original value (at the time at which the consumer entered into the original residential mortgage transaction) of the property securing the loan.

"(h) APPLICABILITY.—This section, other than as provided in subsection (d), shall apply with respect to residential mortgage transactions entered into beginning 90 days after the date of enactment of the Homeowners Protection Act of 1997.".

(b) CLERICAL AMENDMENT.—The table of sections for chapter 2 of the Truth in Lending Act (15 U.S.C.



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1631 et seq.) is amended by striking the item relating to section 126 and inserting the following:

"126. Cancellation rights for private mortgage insurance.".

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